88-157

No. _____

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1987

NATIONWIDE MUTUAL INSURANCE COMPANY,

Petitioner,

v.

HENRY GERRARD CLAY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ALABAMA

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QUESTIONS PRESENTED

A. Punitive Damages

1. Whether allowing an Alabama jury unlimited discretion to impose $1.25 million in punitive damages (25 times the compensatory damages) violates: (A) Due Process under the Fourteenth Amendment of the United States Constitution; (B) the Excessive Fines Clause of the Eighth Amendment as applied to the States through the Fourteenth Amendment; and (C) the Due Process right under the Fourteenth Amendment to advance notice and fair warning of conduct that will give rise to punishment.

2. Whether imposition of punitive damages for asserting non-frivolous legal defenses to plaintiff's claim infringes petitioner's right to access to court and assistance of counsel.

3. Whether enlarging the liability on an insurance contract four years after the contract's consummation, by creating punitive damages liability for "bad faith" refusal to pay a claim, violates petitioner's rights under the Contract and Ex Post Facto Clauses, Art. I, Section 10, Cl. 1 of the United States Constitution.

B. Disqualification

4. Whether members of a collegial appellate bench, after participating in the decision of a case with a member who has a substantial financial interest in its outcome, are disqualified from later deciding the same case where an alternative remedy is available.

C. Imposition of the Abolished Affirmance Penalty

5. Whether a judgment "vacated" by this Court under "grant, vacate and remand for further consideration," may be the basis of a state affirmance penalty that

was repealed before the court below reconsidered its decision on remand.*

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* All parties to this case are named in the caption. The ownership of Petitioner Nationwide Mutual Insurance Company rests solely with its policyholders. The following is a listing of all subsidiaries and affiliates of Nationwide Mutual Insurance Company: Nationwide Mutual Fire Insurance Company, Nationwide Life Insurance Company, Nationwide General Insurance Company, Nationwide Property and Casualty Insurance Company, Nationwide Variable Life Insurance Company, Nationwide Indemnity Insurance Company, National Casualty Company, Michigan Life Insurance Company, Pacific Life Insurance Company, Scottsdale Insurance Company, Farmland Mutual Insurance Company, Farmland Life Insurance Company, Farmland Insurance Company, Colonial Insurance Company of California, NGC County Mutual Insurance Company, Southern Bankers Life Insurance Company, Allnations, Inc., Auto-Direkt Insurance Company, Cedar Springs Life Insurance Company, Columbus Service, GmbH, Corporate Marketing Services, Inc., Cranston-Csuri Productions, Inc., Fazaroli & Davey Administration and Insurance Services, Gates, McDonald and Company of New York, Global Exchange, Gulf Atlantic Life Insurance Company, Hickey-Mitchell Insurance Agency, Inc., I.I.I. Insurance Agency of Texas, Inc., Insurance Intermediaries, Inc., International Cooperative Bank Company, Ltd., Lone Star General Agency, Inc., National Casualty Company of America, Ltd., National Premium and Benefit Administration Company, National Services, Inc., Nationwest Insurance Services, Inc., Nationwide Cash Management Company, Nationwide Communications, Inc., Nationwide Community Urban Redevelopment Corporation, Nationwide Consumer Services, Inc., Nationwide Corporation, Nationwide Development Company, Nationwide Financial Services, Inc., Nationwide Funding, Inc., Nationwide Investing Foundation, Nationwide Investors Services, Inc., Nationwide Foundation, Nationwide/MESCO Insurance Agency, Inc., Nationwide/PEBSCO, Inc., Nationwide Property Management, Inc., Nationwide Separate Account Trust, Nationwide Transport, Inc., Neckura Versicherungs, A.G., Neckura Lebensversicherungs, A.G., NGA, Inc., NSC, Inc., Ohio Farm Bureau Synfuels Investment Company, PEBSCO Municipal Employees Services Corporation, PEBSCO Securities Corporation, Pioneer Automobile Insurance Corporation, Public Employees Benefit Services Corporation, Scientific Assistance Corporation, Wesco Securities, Inc., West Coast Life Insurance Company, Western Credit Corporation.

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NATIONWIDE MUTUAL INSURANCE COMPANY,

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HENRY GERRARD CLAY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ALABAMA

Nationwide Mutual Insurance Company (hereinafter "Nationwide") petitions for a writ of certiorari to review the judgment of the Supreme Court of Alabama below.

OPINIONS BELOW

This case involves two judgments of the Supreme Court of Alabama. The first judgment, reported at 469 So.2d 533 (Ala. 1985), was vacated by Memorandum Order of this Court dated May 5, 1986, in *Nationwide Mutual Insurance Co. v. Clay*, No. 84-1942, 476 U.S. 1101 (1986). *See* App. A, *infra* 1a. The second judgment, to which this petition is addressed, was entered June 26, 1987, and is reported at *Nationwide Mutual Ins. Co. v. Clay*,

525 So.2d 1339 (Ala. 1987). *See* App. B, *infra* 1b. The order of the Supreme Court of Alabama dated April 29, 1988, denying petitioner's Application for Rehearing is reproduced in App. C, *infra* 1c. The Circuit Court of Mobile County, Alabama, issued no opinions.

JURISDICTION

The judgment of the Supreme Court of Alabama affirming the $1,296,165.00 judgment against petitioner was entered on June 26, 1987. App. B, *infra* 1b. Nationwide's Application for Rehearing was denied on April 29, 1988. App. C, *infra* 1c. This petition for a writ of certiorari is being filed within ninety (90) days from the denial, on April 29, 1988, of petitioner's Application for Rehearing in the Supreme Court of Alabama. Jurisdiction exists under 28 U.S.C. § 1257(3).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Ex Post Facto Clause, Art. I, Section 10, cl. 1 of the United States Constitution provides, in pertinent part:

> "No State shall . . . pass any . . . ex post facto law . . .."

2. The Contract Clause, Art. I, Section 10, cl. 1 of the United States Constitution provides, in pertinent part:

> "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . .."

3. The Excessive Fine Clause of the Eighth Amendment of the United States Constitution provides, in pertinent part:

"[N]or [shall] excessive fines [be] imposed . . .."

4. The Due Process Clause of the Fourteenth Amendment of the United States Constitution provides, in pertinent part:

"[N]or shall any State deprive any person of . . . property, without due process of law . . .."

5. The Equal Protection Clause of the Fourteenth Amendment of the United States Constitution provides, in pertinent part:

"[N]or shall any State . . . deny to any person within its jurisdiction the equal protection of the laws."

6. Section 12-22-72, Code of Alabama (1975), repealed June 11, 1987, provided in pertinent part:

"When a judgment . . . is entered . . . for money . . . and the same has been stayed on appeal by execution of bond, with surety, if the appellate court affirms the judgment . . . it must also enter judgment for . . . 10 percent damages thereon and the costs of the appellate court . . .."

7. 1987 Ala. Acts No. 87-188, which became effective June 11, 1987, repealing the 10 percent affirmance penalty, provides in pertinent part:

"Section 3. [The penalty shall not] apply to . . . any lawsuit upon which any judgment has not been rendered and/or all judgments which have not been affirmed by an appropriate appellate court and had a 10 percent penalty assessed . . ..

"Section 6. This Act shall become effective immediately . . .."

STATEMENT OF THE CASE

Introduction

Experience teaches that uniform constitutional standards governing punitive damages will come about only through action of this Court. Indeed, by signalling its intention to address the punitive damages questions in an "appropriate setting," this Court has in effect created a disincentive for Alabama legislators and jurists, all elected officials, to resolve the problem. In this case, unlike *Bankers Life & Casualty Co. v. Crenshaw*, the constitutional issues were raised and briefed before the Supreme Court of Alabama on remand from this Court.[1]

In addition to the punitive damages issues, the protection of public confidence in the courts warrants resolution of the broader disqualification issue which Nationwide again presents. The issue involving the Alabama Supreme Court's imposition on remand of a previously abolished affirmance penalty, which independently warrants relief, is but a factual extension of the disqualification question. Those issues further contribute to this being an appropriate and compelling setting for this Court to resolve the punitive damages questions.

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[1] As mentioned at p.1, *supra*, this case was reviewed on petition for certiorari in *Nationwide Mutual Ins. Co. v. Clay*, No. 84-1942, 476 U.S. 1101 (1986), wherein the Court issued a memorandum order vacating and remanding the original judgment for further consideration in light of *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813 (1986).

A. Material Facts

Respondent sued Nationwide in state court for fraud and breach of contract for refusing to pay full benefits under a contract of disability insurance issued in January, 1977. Respondent's claim was submitted in September, 1977. At that time, Alabama did not recognize a tort cause of action for bad faith failure to pay an insurance claim, such cause of action being first recognized in *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981). Respondent's action having not yet come to trial when *Chavers* was decided, respondent amended his complaint to allege "bad faith" by Nationwide.

At trial in 1982, Nationwide defended on the ground that respondent misrepresented facts in his policy application and, in any event, was not entitled to full contract benefits under a prorating provision in the policy. The trial court submitted the case to the jury under the then new tort theory of bad faith, but gave the jury no instruction as to standards for imposing punitive damages. Alabama law contains no such standards. The jury returned a verdict against Nationwide for $1.25 million in punitive damages. The compensatory award for breach of the contract was $46,165.00.

Nationwide appealed to the Supreme Court of Alabama. That appeal was decided with the participation of then Justice Eric Embry, whose financial interest in the case is discussed in *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813 (1986). The Supreme Court of Alabama, by a 6-3 majority which included Justice Embry, affirmed the trial court's judgment and imposed a mandatory 10 percent affirmance penalty pursuant to then existing Ala. Code

§ 12-22-72 (1975). Upon learning of Justice Embry's interest, Nationwide filed a Motion for Withdrawal of Opinion, which was denied.[2]

Nationwide thereupon petitioned this Court for a writ of certiorari. That petition raised several Federal Constitutional challenges to the judgment of the Supreme Court of Alabama, including the issue of Justice Embry's participation and the unconstitutionality of the $1.25 million punitive damages award. This Court partially addressed the disqualification issue in *Aetna Life Ins. Co. v. Lavoie, supra,* holding the judgment in that case void on account of Justice Embry's participation. The opinion, however, did not address whether such participation disqualified the entire court after the deliberations in which Justice Embry participated. Justice Brennan, concurring, said it did:

> The description of an opinion as being "for the court" connotes more than merely that the opinion has been joined by a majority of the participating judges. It reflects the fact that these judges have exchanged ideas and arguments in deciding the case. It reflects the collective process of deliberation which shapes the court's perceptions of which issues must be addressed and, more importantly, how they must be addressed. And, while the influence of any single participant in this process can never be measured

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[2] Nationwide asserted that to remedy Justice Embry's influence in the collegial decision-making process of that court, it was entitled to an impartial, *de novo* rehearing by a special appeals court empaneled under provisions of Alabama law which allow a special supreme court to be appointed by either the Governor of Alabama or the Chief Justice of the Alabama Supreme Court. *See* Alabama Constitution, Amendment No. 328, section 6.10; Ala. Code § 12-2-14 (1975).

> with precision, experience teaches us that each member's involvement plays a part in shaping the court's ultimate disposition. The participation of a judge who has a substantial interest in the outcome of a case of which he knows at the time he participates *necessarily* imports a bias into the deliberative process. This deprives litigants of the assurance of impartiality that is the fundamental requirement of due process.

475 U.S. at 831. (Brennan, J., concurring)(original emphasis). On May 5, 1986, Nationwide's petition for certiorari was granted and a Memorandum Order issued:

> The judgment is vacated and the case is remanded to the Supreme Court of Alabama for further consideration in light of *Aetna Life Insurance Co. v. Lavoie*, 475 U.S. 813 (1986).

Nationwide Mutual Insurance Co. v. Clay, 476 U.S. 1101 (1986). *See* App. A, *infra* 1a. Justice Embry, meanwhile, retired from the Supreme Court of Alabama.

On remand, the Alabama Supreme Court ordered the case rebriefed and reargued before the remaining justices who participated in the original decision with Justice Embry.[3] Nationwide fully briefed the issues involving the

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[3] The majority opinion of the Supreme Court of Alabama on remand states, "we concluded that a true 'appearance of justice' mandated that we require a complete rebriefing, reargument, and redeliberation of this case with the participation of all nine Justices presently on this Court." App. at 2b. The record, however, reflects that Chief Justice C.C. Torbert and two new associate justices, who heard oral argument, did *not* participate in the decision on remand. Significantly, Nationwide on remand lost two of its three dissenters on the original nine-member court: Chief Justice Torbert as mentioned, and Associate Justice Beatty who, by switching to a special concurrence, provided the necessary fifth vote to reach a majority in reaffirming the judgment.

unconstitutionality of Alabama's punitive damages procedures and again argued that a special supreme court should conduct the rehearing. The original judgment, however, was affirmed on June 26, 1987. *Nationwide Mutual Insurance Co. v. Clay*, 525 So.2d 1339 (Ala. 1987). *See* App. B. Nationwide's Application for Rehearing was denied.

In addition to affirming the $1,296,165.00 judgment against Nationwide, the Supreme Court of Alabama imposed a 10 percent "affirmance penalty" totalling $129,616.50 under Ala. Code § 12-22-72 (1975). That penalty was imposed notwithstanding that the statute on which it was predicated, although in effect at the time of the first affirmance, was repealed prior to the Alabama Supreme Court's affirmance on June 26, 1987. The imposition of that penalty infringes this Court's order vacating the original judgment.

B. The Federal Questions Were Properly Raised

1. Unconstitutionality of Punitive Damages

In its post-trial motion before the state trial court, and on appeal to the Supreme Court of Alabama, Nationwide argued that the $1.25 million punitive damages award was excessive and the product of unrestrained "passion and prejudice" on the part of the jury. In its Application for Rehearing, Nationwide expanded its attack upon the $1.25 million punitive award as violating the Ex Post Facto and Due Process Clauses of the United States Constitution.

In the petition for certiorari to this Court, Nationwide argued that the punitive damages award violated the Due Process Clause of the Fourteenth Amendment, the Contract and Excessive Fines clauses, the Ex Post Facto Clause, and the Fourteenth Amendment right of access to the courts. (Those same issues were raised in the companion case of *Aetna Life Ins. Co. v. Lavoie, supra,* which the Court decided while this case was pending on petition for certiorari.)

On remand to the Supreme Court of Alabama, Nationwide again briefed all of the constitutional arguments pertaining to punitive damages. In proposing a standard for limiting discretionary punitive damages, Nationwide argued that "Due Process requires that actual and punitive damages bear a reasonable relationship to each other." App. at 54f, 65-68f. Nationwide further argued that the $1.25 million punitive award was "excessive under the Excessive Fines Clause of the Eighth Amendment of the United States Constitution," App. at 56-68f, and that the "absence of any consistent standards for remittitur compound the lack of any uniform bounds for submitting the question of punitive damages to the jury, thereby infringing Nationwide's Due Process and Equal Protection rights under the Alabama and United States Constitutions." App. at 8h.

As regards the right to access to courts and assistance of counsel, Nationwide argued that it had a Federal Constitutional right to assert nonfrivolous legal defenses without incurring punishment. App. at 46f. Nationwide further contended that the retroactive imposition of punitive damages, for conduct not then defined as punishable, violated Ex Post Facto Clause principles guaranteed

to civil litigants under the Due Process Clause of the Fourteenth Amendment of the U. S. Constitution. App. at 56f. Nationwide also argued that the newly defined tort of bad faith, on which the punitive damages award was predicated, violated the Contract Clause of the U.S. Constitution. App. at 57f, 62f.

The Supreme Court of Alabama refused to address these issues stating, in pertinent part:

> [Nationwide] claims that the verdict and the judgment entered on that verdict violate the 14th Amendment, the excessive fines clause, and the *ex post facto* clause of the United States Constitution. However, we note that these challenges were not presented for resolution before the trial court and have been presented for the first time on appeal. Resolution of these issues would violate a fundamental principle of appellate jurisdiction: that issues not raised before the trial court may not be raised on appeal.

App. at 10b. As Nationwide demonstrated in its Application for Rehearing to the Supreme Court of Alabama, however, no statute or rule of Alabama procedure prohibits Alabama appellate courts from reviewing a legal issue, constitutional or otherwise, first raised on appeal where that issue is solely a question of law not dependent upon any further development of facts in the trial court. Rather, it has been the rule and practice of Alabama appellate courts to address important constitutional arguments first raised on direct appeal or application for rehearing.

For example, in *State ex rel. Knox v. Dillard*, 196 Ala. 539, 72 So. 56 (1916), the Alabama Supreme Court held that where a question of public concern required consideration of a constitutional issue, it could not refuse to

decide it, whether or not it was raised or argued in the trial court. 72 So. at 60. Similarly, in *Warrior Drilling and Engineering Co. v. King*, 446 So.2d 31 (Ala. 1984), the court stated that although it "generally" will not consider a defense not asserted in the trial court, there may be "circumstances which would justify overriding the general rule." *Id.* at 34.[4] The statement in the opinion below, that the Supreme Court of Alabama is without jurisdiction to entertain these issues, is simply incorrect. That court has the power to review important constitutional issues, which it has exercised as it deemed expedient.

As stated in *Hathorn v. Lovorn*, 457 U.S. 255 (1982), this Court will consider federal questions first raised on appeal to a state's highest court unless the practice of that court is consistently to refuse to consider questions raised at that stage. "State courts may not avoid deciding federal issues by invoking procedural rules that they do not apply evenhandedly to all similar claims." *Id.* at 263. *See also, Barr v. City of Columbia*, 378 U.S. 146, 149 (1964)(state procedural barriers to consideration of important federal questions must be "strictly or regularly followed" in

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[4] *See also, Green v. Taylor*, 437 So.2d 1259, 1260 (Ala. 1983); *Green v. Standard Fire Ins. Co.*, 398 So.2d 671, 676 (Ala. 1981); *Head v. Triangle Const. Co.*, 150 So.2d 389, 392 (Ala. 1963); *Whitman v. Knapp*, 228 Ala. 57, 285 So.2d 57, 63 (1969). Compare, *All South Bonding Co. v. State*, 496 So.2d 786, 787 (Ala.Civ.App. 1986); *Batey v. Jefferson County Bd. of Health*, 486 So.2d 439, 440 (Ala.Civ.App. 1986); *Garrison v. Dothard*, 366 So.2d 1129, 1131 (Ala.Civ.App. 1979); *Crews v. Houston County Dept. of Pensions & Securities*, 358 So.2d 451, 455 (Ala.Civ.App. 1978); *McWilliams v. McWilliams*, 349 So.2d 59, 61 (Ala.Civ.App. 1977).

order to deprive this Court of jurisdiction). The principle enunciated in *Hathorn* was reaffirmed in *Bankers Life and Casualty Co. v. Crenshaw*, No. 85-1765 (May 16, 1988), wherein appellant argued that similar constitutional issues were timely raised on application for rehearing in the Mississippi Supreme Court. The Court concluded that the issues were not sufficiently raised at that stage, but it stated that "*Hathorn* would be apposite were we to conclude that appellant had actually raised its claims on rehearing." Slip op. at 5. As the cases cited above demonstrate, it has not been the consistent rule of the Supreme Court of Alabama to refuse to consider questions of law first raised on appeal.

2. Disqualification of the Appellate Court Below

Disqualification of Justice Embry and the other sitting members of the Supreme Court of Alabama was first raised on February 22, 1985, shortly after Nationwide learned of Justice Embry's financial interest in the case. In its Motion for Withdrawal of Opinion and Suggestion of Disqualification, Nationwide asserted on the basis of Due Process that Justice Embry's participation in the collegial decision rendered the appellate review so unfair that a special court should be appointed as provided under Ala. Code § 12-2-14 (1975). App. at 8-9k. The Supreme Court of Alabama denied Nationwide's motion.

In its earlier petition for certiorari to this Court, Nationwide again argued that participation of a financially interested judge in the collegial decisionmaking process necessitated remand and rehearing before a specially constituted supreme court under either of two Alabama procedures created for such situations. The

majority of this Court in *Aetna Life Ins. Co. v. Lavoie, supra,* did not reach the question whether the entire court should be disqualified. However, Justice Brennan, concurring, said it would.

Prior to briefing and argument on remand to the Supreme Court of Alabama, Nationwide again asserted that a special supreme court should be appointed for rehearing. App. at 2-4i. However, the court ordered that the case be rebriefed and reargued before the other justices who had decided it before, plus two new associate justices on that court. *See* note 3, *supra*. The judgment was then affirmed by a majority of the remaining justices who participated in the original deliberation and decision with Justice Embry. In an Application for Rehearing, Nationwide again protested that the influence of the financially interested judge could not satisfactorily be removed merely by redeliberation of the remaining justices whose perceptions were forged in the original decision where an alternative procedure was available. App. at 10h.

3. Imposition of the Abolished Affirmance Penalty

Nationwide challenged the constitutionality of Alabama's 10 percent affirmance penalty statute in its petition for certiorari following the first opinion by the Supreme Court of Alabama. The issue seemingly became moot on June 11, 1987, when the penalty was repealed by the Alabama Legislature with an express provision that the penalty would cease to apply to judgments affirmed after the effective date of the repeal. 1987 Ala. Acts No. 87-188. *See* p.3, *supra*. The judgment herein was affirmed on June 26, 1987, but the opinion of the Supreme Court of

Alabama said nothing about the affirmance penalty. App. B.

In its Application for Rehearing, and by further letter brief of May 23, 1988, App. J, Nationwide cited the authorities contained herein for the proposition that when this Court "vacates" a judgment of a lower court, the judgment ceases to have legal effect. The Supreme Court of Alabama nevertheless imposed the $129,616.50 penalty in its mandate of May 29, 1988.

C. Reasons For Granting The Writ

I. Unconstitutionality of Punitive Damages

a. The Due Process Clause Issue

State procedures for imposing punitive damages are a "deprivation of property," and as such must satisfy due process. As recognized in *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 429 (1982), the Fourteenth Amendment protects "civil litigants who seek recourse in the courts, either as defendants hoping to protect their property or as plaintiffs attempting to redress grievances."

Due process requires standards for imposing punitive damages sufficiently defined that a civil jury is not left with unlimited discretion in imposing a punitive sanction. This principle is accepted in criminal law, where limitations on the sentencing discretion are a "fundamental constitutional requirement for sufficiently minimizing the risk of wholly arbitrary and capricious action." *Maynard v. Cartwright*, No. 87-519, 56 U.S.L.W. 4501 (June 6, 1988). Without similar procedural safeguards in civil cases, juries are afforded unlimited discretion to assess punitive damages in "wholly unpredictable amounts bearing no necessary relation to the actual harm

caused." *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1973). *See also, Smith v. Wade*, 461 U.S. 30, 59 (1983)(Rehnquist, J., dissenting). As Justice O'Connor observed in *Bankers Life and Casualty Co. v. Crenshaw*, 486 U.S. ___ (1988), such "standardless discretion to determine the severity of punishment appears inconsistent with due process." (O'Connor, J., concurring in part and concurring in the judgment, at slip op. 3).

In this case, the matter of punitive damages was left entirely to the discretion of the jury. The punitive damages instruction in its entirety was:

> Now the purpose of allowing punitive damages or exemplary damages is to allow money recovery to the plaintiff by way of punishment to the defendant for the, and for the added purpose of protecting the public by deterring the defendant and others from committing similar wrongs in the future. [sic] And, that's the purpose of punitive damages.
>
> Now, the imposition of punitive damages and the amount of punitive damages is entirely discretionary with you. Now should you elect to award punitive damages, in fixing the amount of the punitive damages you must take into consideration the character and the degree of the wrong as shown by the evidence in the case and the necessity of preventing similar wrongs in the future.

The jury was given no scales or standards of proportionality in imposing punitive damages. It returned a punitive damages verdict of $1.25 million, more than 25 times the amount of contract benefits awarded as compensatory damages.

Due Process requires that actual and punitive damages bear a reasonable relationship to each other. *See*

generally, Wheeler, M., *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va. L. Rev. 269, 272-78 (1983). Until 1953, that was the rule in Alabama. *Roberson v. McCarley*, 259 Ala. 583, 67 So.2d 814 (1953). In *Roberson* the Supreme Court of Alabama expressed the "general rule" that "the amount awarded as damages must bear some reasonable relation to the injury sustained and even though there might be a small amount of actual damages to be awarded, the amount allowed as punitive damages should not be disproportionate thereto." *Id.* at 817. The court since has forsaken the requirement of proportionality. *See, e.g., Yesterday's, Inc. v. Lamey*, 492 So.2d 988, 990 (1986)("punitive damages need bear no particular relationship to actual damages").

Not only does Alabama procedure provide no guidelines to the jury, it has no appellate standards of remittitur to define the upper limits of a punitive damages verdict. *See, e.g., Alabama Farm Bureau Mut. Cas. Ins. Co. v. Griffin*, 493 So.2d 1379, 1384 (Ala. 1986)("this court has not established specific standards for trial courts to apply in granting or denying new trial motions on the grounds of excessiveness").

Nationwide does not seek prohibition of punitive damages, nor preclusion of some scope for jury discretion in fixing the amount of a punitive award. However, no state interest is furthered by a procedure allowing unfettered discretion yielding grossly disproportionate punitive damages. Accordingly, the procedure under which the Alabama jury exercised such discretion to impose $1.25 million in punitive damages violates the Due Process Clause of the Fourteenth Amendment.

b. The Excessive Fines Clause

This Court is familiar with the proposition that the Excessive Fines Clause of the Eighth Amendment, applicable to the states through the Due Process Clause of the Fourteenth Amendment, should govern the size of punitive damages awards in civil actions. Those arguments were briefed extensively by appellants and *amici curiae* in *Bankers Life & Casualty Co. v. Crenshaw*, No. 85-1765 (May 16, 1988), and *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813 (1986), and are fully relevant here.

Punitive damages "serve the same function as criminal penalties and are in effect private fines." *Rosenbloom v. Metromedia, Inc.*, 403 U.S. 29, 82 (1971)(Marshall, J., dissenting); *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974)(punitive damages "are private fines levied by civil juries"). Furthermore, neither the language nor the history of the Excessive Fines Clause suggests that the ban against excessive fines has exclusive application to criminal law.

The prohibition against excessive fines may be traced to the Magna Carta. *See* Jeffries, J., *A Comment on the Constitutionality of Punitive Damages*, 72 Va. L. Rev. 139 (1986); Massey, C., *The Excessive Fines Clause and Punitive Damages: Some Lessons From History*, 40 Vand. L. Rev. 1234 (1987). Chapter 20 of the Magna Carta guaranteed that:

> A freeman shall not be amerced for a slight offense, except in accordance with the degree of the offense; and for a grave offense he shall be amerced in accordance with the gravity of the offense . . ..

See Jeffries, *supra*, at 155. That protection was carried forward in the Eighth Amendment, *see Solem v. Helm*, 463

U.S. 277, 285-86 n.10 (1982), as applied to the states under the Due Process Clause of the Fourteenth Amendment.

The punitive "fine" must be reasonably proportionate to the actual harm, as reflected by compensatory damages. Furthermore, under the Equal Protection guarantee the punitive awards should be fairly consistent in cases involving similar wrongs.[5] The punitive damages here exceeded 25 times the award for breach of contract. Such a disproportionate punitive award, combined with the absence any consistent standards of appellate review in determining excessiveness, violates the Excessive Fines Clause.

c. Chilling the Assertion of Legal Rights

The punitive damages imposed here were for asserting nonfrivolous legal defenses. That infringes the right of access to court and to seek assistance of counsel.

One of Nationwide's defenses was that respondent was not entitled to full contract benefits under a prorating provision in the policy. Respondent disputed that defense, contending he was entitled to full benefits. The trial court partially sustained Nationwide's defense by entering a directed verdict on the contract claim for an amount *less* than full contract benefits, demonstrating *a fortiori* that Nationwide had at least an arguable defense.

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[5] The inconsistency in punitive damages sanctions in Alabama is reflected in comparing the result of this case ($1.25 million) with two other "bad faith" cases from the same Alabama trial court rendered within weeks of each other and then reviewed on appeal. *See Aetna Life Ins. Co. v. Lavoie*, 470 So.2d 1060 (Ala. 1984)($3.5 million award affirmed; later remitted to $500,000 after remand from this Court); *Continental Ins. Co. v. Kountz*, 461 So.2d 802 (Ala. 1984)($25,000 affirmed). The range of these three punitive damages verdicts is in the ratio of 140:1.

The court nevertheless permitted the jury to award $1,250,000 in punitive damages.

Imposing punitive damages under such circumstances substantially infringes the Due Process right of a civil litigant to access to court and to assistance of counsel in a matter where the party has a non-frivolous legal contention. The effect of permitting such an award is that a party cannot risk asserting a valid legal defense if the amount in controversy is exceeded by the amount potentially at risk in punitive damages. Since the punitive liability can exceed $1 million, and did so in this case, the rule applied herein chills the assertion of a legal position about which there is any significant uncertainty.

In *New York Times v. Sullivan*, 376 U.S. 254 (1964), and *Gertz v. Robert Welch, Inc.*, 418 U.S. 323 (1974), this Court held that punitive damages are impermissible where their effect is to chill exercise of free speech protected by the First Amendment as incorporated by the Fourteenth Amendment. That same principle should protect a civil litigant's rights of access to court and to consultation with counsel, rights also protected by the Fourteenth Amendment. *Cf. International Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42 (1979) (prospect of punitive damages for "unfair representation" would chill the discretion of labor unions in litigating grievances).

The Fourteenth Amendment protects "civil litigants who seek recourse in the courts, either as defendants hoping to protect their property or as plaintiffs attempting to redress grievances." *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 429 (1982). Due process protects the right of access to court to defend against litigation, *Collex, Inc. v.*

Walsh, 394 F. Supp. 225 (E.D.Pa. 1975), and encompasses the right to seek judicial resolution of grievances without punishment. *See Laaman v. Perrin*, 435 F. Supp. 319 (D.N.H. 1977). *See also*, Wheeler, M., *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va. L. Rev. 269, 277 (1983).

d. Fair Warning of Punitive Sanction

This Court has held that the Ex Post Facto Clause limits the powers of the legislature and does not of its own force apply to the judicial branch. *See Frank v. Mangum*, 237 U.S. 309 (1915). However, the "fair warning" principle contained in the Ex Post Facto Clause is "fundamental to our concept of constitutional liberty," and is a component of Due Process. *Marks v. United States*, 430 U.S. 188, 191-92 (1977).

There is a constitutional right to notice of any conduct that will give rise to punishment, a right protected against judicial infringement by the Due Process Clause of the Fifth Amendment. *Marks v. United States*, 430 U.S. at 192. In *Marks*, the Court observed that a retroactive *judicial* enlargement of a criminal statute operates as an ex post facto law. *Id.* Since a state legislature is barred by the Ex Post Facto Clause from passing retroactive laws, the Court stated, "it must follow that a state supreme court is barred by the Due Process Clause from achieving precisely the same result by judicial construction." *Id. See also, Bouie v. City of Columbia*, 378 U.S. 347, 354 (1964). *Marks* involved the judicial enlargement of a quasicriminal federal statute prohibiting transportation of obscene materials. Its rationale should apply equally to the

retroactive enlargement of an established common law remedy and the assessment of punitive damages thereunder.

The punitive damages judgment against petitioner in the present case was imposed under a legal standard adopted four years after the transaction to which it was applied. At the time respondent submitted his claim to Nationwide in 1977, Alabama did not recognize the tort of bad faith. There still was no tort of bad faith when suit was filed on July 14, 1978. The Supreme Court of Alabama first defined a cause of action for "bad faith" failure to pay insurance benefits in *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981). Respondent thereupon amended his complaint to assert such a cause of action for conduct that occurred in 1977-78, which was the basis of the $1.25 million punitive damages award.

Earlier in the same year in which the tort of "bad faith" was judicially created, the Alabama Legislature enacted a statutory penalty against insurers for overdue benefits in the amount of 1.5 percent per month. Ala. Code § 27-1-17 (1975). As the Supreme Court of Alabama has held that such statutory remedies may not apply retroactively, *see, e.g., Tyson v. Johns-Manville Sales Corp.*, 399 So.2d 263, 269 (Ala. 1981); *City of Brewton v. White's Auto Store*, 362 So.2d 226, 227 (Ala. 1978), that legislative remedy could not have been asserted against petitioner for the conduct in 1977-78. The Supreme Court of Alabama, however, undertook what the legislature could not, by creating a new legal standard, upon pain of substantial punitive damages, after the fact of the conduct sought to be redressed. That action offends principles of fair

warning of punishable conduct guaranteed to civil litigants under the Due Process Clause of the Fourteenth Amendment.

e. The Contract Clause

The $1.25 million punitive damages award, based on a subsequently defined cause of action, unconstitutionally impaired a private contractual obligation in violation of the Contract Clause, Art. I, Section 10, cl. 2, of the U. S. Constitution. The parties to this action entered into a contract in January, 1977, contemplating the obligations arising from Alabama law as it then stood. The Supreme Court of Alabama unconstitutionally enlarged those obligations by retroactively applying the punitive remedy first articulated in *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981), four years after the contract was entered into.

Whether a state court may retroactively alter a contract of insurance parallels the issue in *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, *reh. denied*, 99 S.Ct. 233 (1978), wherein the Court invalidated a state statute that retroactively imposed a duty to make additional payments under a pension plan. The judicially-created retroactive law in this case similarly enlarged the contractual obligations between Nationwide and respondent.

II. Disqualification of the Appellate Court Below

a. The Financial Interest of Justice Embry

In *Aetna Life Insurance Co. v. Lavoie*, 475 U.S. 813 (1986), this Court invalidated a $3.5 million judgment of

the Supreme Court of Alabama on account of the unconstitutional participation of Justice Eric Embry in the decision in that case. The Court held that Justice Embry's interest in the tort of bad faith, and affirmance of large punitive damages awards thereunder, constituted a substantial financial interest in the outcome of the case.

In addition to challenging the participation of Justice Embry in this case, Nationwide argued that the other members of that collegial court should be disqualified due to Justice Embry's influence in the deliberative process. On May 5, 1986, this Court vacated the judgment of the Supreme Court of Alabama and remanded this case for further consideration in light of the Court's opinion in *Lavoie, supra*. However, the majority decision in *Lavoie* did not reach the broader question of whether Justice Embry's influence necessitated disqualification of the other justices on the Supreme Court of Alabama who participated with him in the court's deliberation and decision. As noted, Justice Brennan's concurring opinion answered that question in the affirmative.

b. Justice Embry's Participation Disqualified the Entire Court Below

Members of a collegial bench committing themselves to a decision in the face of known bias in their composition may not later decide the same matter, at least if an adequate alternative remedy is available. The judges participating in a collegial decision, if they engage in the exchange of views called for by the nature of their office, take account of the views of each participating judge. Such collegial interaction is particularly significant where the case involves a new cause of action still being defined

by the court. In the present case, Justice Embry's participation in the decision-making process infected the entire Alabama Supreme Court with unconstitutional bias.

As Justice Brennan, concurring, recognized in *Aetna Life Insurance Co. v. Lavoie, supra,* bias is necessarily imported into the deliberative process when a financially interested judge participates in a collegial appellate decision:

> [T]he description of an opinion as being "for the court" connotes more than merely that the opinion has been joined by a majority of the participating judges. It reflects the fact that these judges have exchanged ideas and arguments in deciding the case. *It reflects the collective process of deliberation which shapes the court's perceptions of which issues must be addressed and, more importantly, how they must be addressed.*

89 L.Ed.2d at 839. (Brennan, J., concurring)(emphasis added). Those biased perceptions cannot satisfactorily be removed merely by redeliberation of the justices whose collective impartiality has been questioned. As recognized in *Liljeberg v. Health Services Acquisition Corp.,* No. 86-957, 56 U.S.L.W. 4637 (June 17, 1988), fairness in judging is a matter of appearance to the "objective observer," not merely a question of the justices satisfying themselves. The remaining justices, being "the court" with which an interested justice participated and influenced the outcome, should not be allowed simply to redecide the matter if an adequate alternative procedure is available.

As discussed at note 2, *supra,* there are two procedures under Alabama law whereby a special supreme court may be constituted to decide an appeal. Such a

tribunal may be established under Ala. Code § 12-2-14 (1975), which provides that a special supreme court may be appointed by the Governor of Alabama. That procedure was followed in *Ex parte Alabama Power Co.*, 280 Ala. 586, 196 So. 2d 702 (1967), when all the justices recused themselves because the plaintiff was a justice of the Supreme Court of Alabama. An even simpler procedure is available under a 1973 amendment to the Alabama Constitution, which enables the chief justice to assign appellate or trial judges, active or retired, "for temporary service in any court." Alabama Constitution, Amendment 328, Section 6.10. That procedure was utilized in *Duncan v. Johnson*, 338 So.2d 1243 (Ala. 1976), when all the justices recused themselves because one of them "had represented one of the parties to the litigation." *See Aetna Life Insurance Co. v. Lavoie*, 470 So.2d 1060, 1092 n.1 (Ala. 1987) (Maddox, J., concurring).

In *Ex Parte Alabama Power Co., supra,* and *Duncan v. Johnson, supra,* all the justices of the Supreme Court of Alabama recused themselves where only one of their number was disqualified for imputed bias under state law. In this case, however, the court declined to use that procedure to vindicate a standard of imputed bias established by the United States Constitution. Those state law remedies should be equally available for a federal as well as a state ground of recusal.

III. Imposition of the Abolished Affirmance Penalty

The Supreme Court of Alabama's imposition of the now abolished 10 percent affirmance penalty infringes this Court's previous Memorandum Order wherein the

original judgment was "vacated." An order that a judgment is "vacated" renders it of no precedential value. *County of Los Angeles v. Davis*, 440 U.S. 625, 634 n.6 (1979). Therefore, on remand, this case before the Alabama Supreme Court was in the same posture as when it was first appealed from the trial court. *See Tims v. Holland Furnace Co.*, 152 Ohio St. 469, 90 N.E.2d 376, 380 (1950)("generally accepted rule is that where a court . . . vacates an order or judgment . . . the legal status is the same as if the order or judgment had never existed"). *Accord, Riha v. International Tel. & Tel. Corp.*, 533 F.2d 1053, 1054-55 (8th Cir. 1976); *Mitchell v. Joseph*, 117 F.2d 253, 255 (7th Cir. 1941).

If the original judgment had never existed, which is the effect of a "vacated" judgment, the penalty would not apply to any subsequent affirmance by operation of the express terms of the legislative act which repealed it. *See Alabama Power Co. v. Capps*, 519 So.2d 1328, 1330 (Ala. 1988) (penalty not effective as to judgments affirmed after June 11, 1987). The Supreme Court of Alabama nonetheless imposed the penalty of $129,626.50 as though the predicate judgment had never been set aside by this Court's order. To the extent the Supreme Court of Alabama imposed that penalty, despite the express language of the repealer statute and its own holding in *Alabama Power Co. v. Capps, supra*, its judgment offends both this Court's order and the law of the case laid down by this Court in vacating the original judgment.

Respectfully submitted,

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APPENDIX

A. *Nationwide Mutual Ins. Co. v. Clay*, No. 84-1942, 476 U.S. 1101 (1986) 1a

B. *Nationwide Mutual Ins. Co. v. Clay*, 525 So.2d 1339 (Ala. 1987) 1b

C. Order denying Application for Rehearing 1c

D. Judgment of Supreme Court of Alabama 1d

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F. Brief of Appellant Nationwide 1f

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I. Reply Memorandum of Nationwide to Clay's Request for Briefing Schedule 1i

J. Nationwide's Letter Brief of May 23, 1988 ..... 1j

K. Motion for Withdrawal of Opinion and Suggestion of Disqualification 1k

L. Amendment to Motion for Withdrawal of Opinion 1l

Appendix A

Supreme Court of the United States

No. 84-1942

Nationwide Mutual Insurance Company,

Petitioner,

v.

Henry Gerrard Clay

ON WRIT OF CERTIORARI to the Supreme Court of Alabama.

THIS CAUSE having been submitted on the petition for writ of certiorari and response thereto,

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this Court that the judgment of the above court in this cause is vacated with costs, and that this cause is remanded to the Supreme Court of Alabama for further consideration in light of *Aetna Life Insurance Co. v. Lavoie*, 475 U.S. ___ (1986).

IT IS FURTHER ORDERED that the petitioner, Nationwide Mutual Insurance Company, recover from Henry Gerrard Clay Two Hundred Dollars ($200.00) for their costs herein expended.

May 5, 1986

Clerk's costs: $200.00

Appendix B

THE STATE OF ALABAMA.... JUDICIAL DEPARTMENT

IN THE SUPREME COURT OF ALABAMA

OCTOBER TERM, 1986-87

Nationwide Mutual Insurance Company

82-536 v.

Henry Gerrard Clay

and

Nationwide Mutual Insurance Company,
a corporation

82-917 v.

Henry Gerrard Clay

Appeals from Mobile Circuit Court

On Remand from the Supreme Court
of the United States

(June 26, 1987)

PER CURIAM.

This case comes to us again on remand from the Supreme Court of the United States. The judgment of this Court was vacated and the case was remanded to us for further consideration in light of *Aetna Life Insurance co. v. Lavoie*, 475 U.S. ___, 106 S.Ct. 1580, 89 L.Ed.2d ___ (1986). In the *Lavoie* case, the judgment was vacated because one of the Justices of this Court had authored the opinion in a 5 - 4 decision involving the tort of bad faith when he contemporaneously was litigating a tort of bad faith claim against another insurance company. The Supreme Court of the United States concluded that as a participating judge in the *Lavoie* case, he was "a judge in his own case." As a result, his interest in the *Lavoie* case was

"direct, personal, substantial, [and] pecuniary." Because of "due process" concerns, the Supreme Court opined that "the appearance of justice" would be best served if this Court proceeded to review the *Lavoie* case without participation by the offending Justice. By a subsequent mandate, we are now required to review the issues in the instant litigation in light of the principles enunciated in *Lavoie*.

No perimeters were set forth in the Supreme Court's vacation of our judgment in this case. As a result, the plaintiff Clay suggested that the non-disqualified members of the Court merely affirm the decision and allow the former judgment to stand. This is because the decision in this case, as contrasted with that in *Lavoie*, was a 6-3 decision. The elimination of the offending Justice's vote would allow the judgment to stand because it would still have the sufficient five votes to constitute a majority. However, we concluded that a true "appearance of justice" mandated that we require a complete rebriefing, reargument, and redeliberation of this with the participation of all nine Justices presently on this Court. The result of our deliberations is that the judgment of the trial court is affirmed.

Although our prior opinion in this case, 469 So. 2d 533, contained an extensive statement of facts, we will, for purposes of this opinion, state again briefly the events leading up to the filing of this suit.

On June 14, 1966, Henry Gerrard Clay, a practicing attorney, took out a disability income insurance policy with Paul Revere Insurance Company. Over ten years later, on December 8, 1976, Clay was contacted by a

friend of his, Bill McDowell, an agent for Nationwide Mutual Insurance Company, about applying for a disability policy with Nationwide. In the application for insurance, Clay stated that his monthly income was $1,800.00. After Nationwide's doctor gave Clay a "clean bill of health," Nationwide issued Clay a disability income policy, effective January 19, 1977. Clay also promised to cancel a disability policy he had with Paul Revere Insurance Co.

Clay then contacted Paul Revere Insurance Company to cancel his policy of insurance with it. Upon receipt of Clay's intent to cancel his disability policy, an agent of Paul Revere contacted Clay in an attempt to change his mind. After much discussion, Clay agreed to a new disability income policy with Paul Revere. According to the agent who sold Clay the policy, he told Clay that Paul Revere would cancel his old policy and take the same amount and incorporate it into a new policy. Clay then attempted to cancel his Nationwide policy, but could not get in touch with his agent, McDowell, because McDowell had been promoted and transferred to another town. A few weeks later, when Clay received a policy from Nationwide in the mail, he again attempted to contact McDowell to have this policy cancelled. It was at this time that Clay was first informed that McDowell had been promoted and that this was why he was having trouble contacting him.

On August 29, 1977, Clay first realized that he was having difficulty reading. On that day, he went to see Dr. Ross, an optometrist. Ross examined Clay and diagnosed cataracts. This was the first time anyone had diagnosed Clay as having cataracts. On September 7, Clay saw Dr.

Harrison, who confirmed that he had cataracts. Dr. Harrison told him that the cataracts would get worse, and that eventually he would go blind. On this day, Clay closed his law office. Approximately three weeks later, Clay filed a disability claim with Nationwide. Clay's claim was assigned to Jim Otey, a Nationwide medical claims examiner. Clay first had communication with Otey in October of 1977. For a period of almost a year, Clay had extensive communications with Otey and with John Harker, a claims attorney for Nationwide. Several of Clay's phone calls to Otey and Harker were never returned, and when Clay was able to contact either person, he was often given what he called a "run around." Specifically, Clay was told that certain documents were not in his file when the person knew of these documents were in his file. Also, certain letters and other papers necessary for the processing of his claim were stamped "filed" by Nationwide, but persons investigating the claim either did not find them or did not bother to take the time to check to see if indeed these papers were in the possession of Nationwide.

After several doctors had examined Clay and confirmed that he had cataracts, Harker agreed that Clay was disabled; however, Harker claimed that this was a preexisting condition, and, therefore, said that Nationwide was not going to pay on the claim. Clay even corresponded with O. B. Car of the Alabama Insurance Commission and complained about the treatment he was receiving from Nationwide. After two or three calls and letters from Carr, as well as numerous unanswered phone calls and letters from Clay, Harker finally authorized a payment of $1,300.00 to Clay on January 19, 1978. The

check was not received by Clay until almost a month later. Even after payment of this $1,300.00, Nationwide was still three months in arrears. Furthermore, Nationwide was regularly withdrawing a monthly premium from Clay's checking account, even though Clay's policy had a waiver of premium provision that should have taken effect. Over the next four months, Clay had several more communications with Nationwide. At one point, Clay told Harker that he was contemplating filing suit, to which Harker replied, "go ahead, but you won't receive one nickel for ten years," Finally, after numerous attempts by Clay to have the matters resolved, he filed suit against Nationwide on July 14, 1978.

Even as late as October 1978, Clay was trying to have the automatic payment of his premium stopped. Nationwide's only response was that if he ceased making premium payments, he would not be entitled to further payments on his claim. In an interrogatory addressed to Nationwide as to why it was continuing to require Mr. Clay to pay the premiums on the disability insurance policy, Nationwide answered that "presumably any payments made by Mr. Clay were made voluntarily by him."

Although Nationwide makes numerous arguments as to why the judgment in this case should be set aside, the arguments are directed to two main issues. Issue one is whether the trial court properly submitted the issue of bad faith to the jury. Issue two is whether the award of $1.25 million in punitive damages for bad faith failure to pay $46,000.00 in disability benefits was excessive. We are of the opinion that the trial court's resolution of both issues was proper. Before addressing Nationwide's arguments individually, we note that "whether an insurance

company is justified in denying the claim on the policy must be judged by what was before it *at the time the decision was made." National Security Fire & Casualty Insurance Co. v. Vintson,* 454 So. 2d 942 (Ala. 1984). Thus, evidence favorable to an insurer that arises after a bad faith denial should not be relevant to the propriety of the conduct of the insurer at the time of its refusal.

Nationwide first asserts that there was a genuine dispute over the amount of the benefits owed, and that this justified its denial of the claim. However, the calculation of benefits was not an issue at the time Nationwide denied the claim. Rather, Nationwide, at that time, took the position that Clay was not disabled or, alternatively, that his disability pre-existed the issuance of the insurance policy. Nationwide asserts in its brief that it is undisputed that Clay demanded full contract benefits under the policy, but the record indicates that Clay never demanded any specific amount, but only whatever was due him. Clay was never informed by Nationwide that it was unable to calculate the amount of the claim, or that the claim was subject to proration.

Nationwide's next argument is that it had a debatable reason to refuse to pay Clay because he made various misrepresentations in his application for insurance. Nationwide states that Clay represented that he was going to cancel the Pual Revere policy, but did not cancel it, and, instead, increased the amount of his coverage. There is no proof, however, that Clay did not *intend* to cancel the Paul Revere policy at the time he filled out the Nationwide application. The facts indicate that Clay called Paul Revere in order to cancel the policy and was later convinced by Paul Revere that he should not cancel.

This was the testimony of Clay, and there is no evidence from Nationwide to the contrary. Thus, the evidence on record indicated that it was Clay's intent to cancel the policy when he filled out the application for insurance with Nationwide. There is further evidence that he thought he did cancel the policy and that a *new* policy was issued for a higher coverage. The fact that the new policy was simply a "makeover policy" is not relevant to the issue of Clay's *intent* to cancel at the time he filled out the application with Nationwide. *Lawson v. Cagle*, 504 So. 2d 226 (Ala. 1987).

Nationwide argues that Clay also misrepresented his average monthly earnings. However, it is undisputed that Nationwide never informed Clay that "average monthly income" meant "net income." Even so, Nationwide's choice of a single 12-month period in estimating average monthly income has no rational basis. Any other time period chosen would reveal that Clay's average monthly income was well in excess of $1,800.00 a month, even subtracting operating expenses. Since there was no evidence that Clay knew that the figure he was to put down concerning his average monthly income was supposed to be a "net income" per month, this ambiguity in the question on the application was correctly construed against the insurer by the trial court.

Finally, Nationwide had no lawful basis to deny the payment based on misrepresentation in the application, because, as a matter of law, it waived such a defense by continuing to demand and collect premiums. By collecting premiums, Nationwide was ratifying the existence of a contract, which is inconsistent with its position on

appeal that misrepresentations on the part of Clay voided any contract.

On appeal, for the first time, Nationwide raises a claimed lack of cooperation on the part of Clay as a defense to the claim. This issue is meritless, because there is no evidence in the record whatsoever that Clay's alleged refusal to cooperate was the reason the company failed to pay the claim. To the contrary, all the evidence produced at trial showed that Nationwide was the one that failed to cooperate. Since this was not raised as an affirmative defense at the trial, this Court will not consider it on appeal. *Green v. Taylor,* 437 So. 2d 1259 (Ala. 1983); *Simmons Machinery Co. v. M & M Brokerage, Inc.*, 409 So. 2d 743 (Ala. 1981). Even if we were to consider Nationwide's claim of lack of cooperation on Clay's part, inasmuch as Nationwide breached its own duty of good faith and fair dealing in handling the claim, Clay was excused from further obligation on his part under the policy. Under general principles of contract law, a substantial breach by one party excuses further performance by the other. See *Smith v. Clark,* 341 So. 2d 720 (Ala. 1977).

Finally, Nationwide argues that its four payments of $1,300.00 each during the pendency of its investigation satisfied the requirements of good faith in dealing with Clay and that this was sufficient to keep the issue of bad faith from going to the jury. As with the lack-of-cooperation issue, partial payment was never raised as a defense to the claim, as required by Rule 8(c), Alabama Rules of Civil Procedure. It cannot, therefore, be raised on appeal. *Green, supra,* and *Simmons, supra.*

The cases cited by Nationwide in support of its argument that partial payment exempted it from liability for bad faith are all distinguishable from the present case in one respect: in each of those decisions, the Court found no evidence of bad faith in the refusal to pay a claim. It is ludicrous to suggest that partial payment could avert liability altogether. If this were the case, then partial payment could be used simply as a guise to conceal an otherwise intentional denial of the claim. Rather, partial payments in this case are evidence of the fact that Nationwide tried to delay full recognition of Clay's claim for an extended period of time. *Sexton v. Liberty National Insurance Co.*, 405 So. 2d 8 (Ala. 1981); *Cincinnati Ins. Co. v. Little*, 442 So. 2d 891 (Ala. 1983); *Bowers v. State Farm Mut. Auto. Ins. Co.*, 460 So. 2d 1288 (Ala. 1984); *National Sec. Fire & Cas. Co. v. Bowen*, 417 So. 2d 179 (Ala. 1982).

Other than the five reasons discussed above, there are several other instances during the almost ten-month period in which bad faith refusal to pay was demonstrated on the part of Nationwide. Nationwide first took the position that Clay was not disabled, which was directly contradicted by several doctors' reports (which were shown to be in the hands of Nationwide when it denied the claim), showing that Clay was, indeed, disabled. When this position seemed to no longer be maintainable, Nationwide argued that the condition preexisted the policy. Again, Nationwide had in its possession a report showing that this was not the case. Nationwide then took a frivolous position when it asserted that Clay failed to undergo surgery and, therefore, did not mitigate his claim. This assertion hardly needs to be

discussed, as there is no duty or requirement on the part of a disabled person to have surgery.

The record is replete with examples of Nationwide's intentional failure to investigate Clay's claim. The tort of bad faith was recognized to deal with just this type of situation. Therefore, the trial court was correct in allowing the issue of bad faith to go to the jury. *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So. 2d 916 (Ala. 1981); *National Sec. Fire & Cas. Co. v. Vintson*, 454 So. 2d 942 (Ala. 1984); *Federal Guaranty Life Ins. Co. v. Wilkins*, 435 So. 2d 10 (Ala. 1983); *National Sav. Life Ins. Co. v. Dutton*, 419 So. 2d 1357 (Ala. 1982); *National Sec. Fire & Cas. Co. v. Bowen*, 417 So. 2d 179 (Ala. 1982); *Chavers v. National Sec. Fire & Cas. Co.*, 405 So. 2d 1 (Ala. 1981); *Continental Ins. Co. v. Kountz*, 461 So. 2d 802 (Ala. 1984).

Nationwide argues that, assuming without admitting, there was a bad faith claim sufficient to go to a jury, the jury award of $1.25 million in punitive damages for bad faith failure to pay $46,000.00 in disability benefits was excessive. Nationwide makes this challenge to the jury verdict on federal and state constitutional grounds, as well as on the basis of our case law. It claims that the verdict and the judgment entered on that verdict violate the 14th Amendment, the excessive fines clause, and the *ex post facto* clause of the United States Constitution. However, we note that these challenges were not presented for resolution before the trial court and have been presented for the first time on appeal. Resolution of these issues would violate a fundamental principle of appellate jurisdiction: that issues not raised before the trial court may not be raised on appeal. *Green, supra.*

On state law grounds, Nationwide argues that punitive damages should bear some particular mathematical relationship to compensatory damages. However, we have repeatedly held that punitive damages need not *necessarily* bear any particular relationship to compensatory damages. *U-Haul Company of Alabama v. Long*, 382 So. 2d 545 (Ala. 1980). We have said that decisions on punitive damages must be made on a case-by-case basis, and it is clear from our cases that this Court is willing to uphold substantial jury awards for damages, even in excess of $1,000,000, when the facts warrant such an award.

The facts, as stated in this opinion, clearly show that the jury's award was warranted. Furthermore, there is no evidence that the jury's verdict was based on "bias, prejudice, corruption, or other improper motive." The trial court, properly denied Nationwide's motion for JNOV, new trial, or remittitur. The judgment is, therefore, affirmed.

AFFIRMED.

Jones, Almon, Shores, and Adams, JJ., concur.

Beatty, J., concurs specially.

Maddox, J., dissents.

Beatty, Justice (concurring specially).

Upon a full review of the record in this case, I find that it appears conclusively that there was evidence from which a jury could have found that Nationwide acted in bad faith when it first denied Clay's claim. At the time of this first denial, Nationwide had in its possession reports

from several physicians, none of which supported the basis for Nationwide's denial of the claim, *viz.*, that Clay's cataracts were a pre-existing condition. While the various physicians' reports indicated that Clay's cataracts had begun to develop prior to the date they were diagnosed, August 29, 1977, *none* of the reports indicated that Clay's cataracts existed or had begun to develop prior to the effective date of his policy with Nationwide, January 19, 1977. Indeed, Dr. Allen's December 14, 1976, report indicated that Clay was having no problems with his eyes at that time. Clearly, these facts made the issue of bad faith a question for the jury.

MADDOX, JUSTICE (Dissenting).

If the Court would reduce the amount of the judgment in this case to the sum of $100,000, the amount Clay sought on his *contract* claim, I would concur in the opinion.

Because I am of the opinion that there was a debatable reason for Nationwide's refusal to pay this claim, I believe that Nationwide was entitled to a directed verdict on the bad faith claim. While I believe that the trial court erred in directing a verdict for Clay on his contract claim, I would not reverse the judgment and order a new trial, because of the particular circumstances of this case, but I would require an addittitur of that judgment to allow Clay to recover the full amount he sought on the contract claim, $100,000. In my special concurrence in *Aetna Life Insurance Co. v. Lavoie*, 505 So. 2d 1050 (Ala. 1987), I set out my views on the development of the law of bad faith failure to pay an insurance claim, and I concurred in the

conditional affirmance of the judgment in that case, because I was of the opinion that certain consequential damages should be permitted in a case invoad faith claimlving an alleged breach of a non-commercial insurance contract, and I called upon the legislature to address the problem that is presented in cases such as the one here.

In this case, Clay, in addition to his claim for damages for breach of the contract, also asked for damages for "mental anguish." As I pointed out in my special concurrence in *Aetna Life Insurance Co. v. Lavoie*, I am of the opinion that this alternative to the bad faith theory of recovery should be adopted by this Court. Because I am of the opinion that the evidence would support a jury verdict on the contract claim for the specific damages Clay claimed in his complaint, I would concur in the result to affirm conditionally upon Clay's filing a remittitur of all but $100,000.00 of the damages awarded. Because the Court affirms the judgment on the bad faith claim without requiring a remittitur, as was done in *Aetna Life Insurance Co. v. Lavoie*, I must respectfully dissent.

Appendix C

82-536 and 82-917

On Application for Rehearing

(Released April 29, 1988)

PER CURIAM.

Application for rehearing overruled.

Jones, Almon, Shores, and Adams, JJ., concur.

Maddox and Beatty, JJ., concur specially.

Torbert, C. J., Houston, and Steagall, JJ., not sitting.

MADDOX, JUSTICE (Concurring specially).

I agree that the application for rehearing should be overruled, but I point out that on original deliverance I dissented and stated that "I would concur in the result to affirm conditionally upon Clay's filing a remittitur of all but $100,000 of the damages awarded."

I am still of the opinion that the judgment should be affirmed conditionally, but I concur with the holding of the majority that Act No. 188, Ala. Acts 1987, which amended Ala. Code 1975, § 12-22-72 and § 12-22-73, which provided for a statutory affirmance penalty of 10%, has no application in this case.

Appendix D

June 26, 1987

THE STATE OF ALABAMA– –JUDICIAL DEPARTMENT
IN THE SUPREME COURT OF ALABAMA

82-536 and 82-917

NATIONWIDE MUTUAL
INSURANCE COMPANY

v.

HENRY GARRARD CLAY

MOBILE CIRCUIT COURT

#CV 78-001148-K

This cause having been submitted on remand from the Supreme Court of the United States, IT IS CONSIDERED, ORDERED AND ADJUDGED that the judgment of the circuit court is now affirmed.

IT IS FURTHERED ORDERED that the appellant pay the costs of appeal as provided by the Alabama Rules of Appellate Procedure, for which let execution issue.

OPINION PER CURIAM
JONES, ALMON, SHORES AND ADAMS, JJ., CONCUR;
BEATTY, J., CONCURS SPECIALLY;
MADDOX, J., DISSENTS.

Appendix E

June 7, 1988

THE STATE OF ALABAMA– –JUDICIAL DEPARTMENT
IN THE SUPREME COURT OF ALABAMA

82-536 and 82-917

NATIONWIDE MUTUAL
INSURANCE COMPANY

v.

HENRY GARRARD CLAY

MOBILE CIRCUIT COURT

#CV 78-001148-K

IT IS ORDERED that the judgment entered in this cause on June 26, 1987, be, and the same is hereby, amended to read as follows:

This cause having been submitted on remand from the Supreme Court of the United States, IT IS CONSIDERED, ORDERED AND ADJUDGED that the judgment of the circuit court is now affirmed.

IT IS FURTHERED ORDERED AND ADJUDGED that the appellant, Nationwide Mutual Insurance Company, and Fidelity and Deposit Company of Maryland, surety on the supersedeas bond, pay the amount of the judgment of the circuit court plus ten percent damages and interest and the costs of appeal as provided by the Alabama Rules of Appellate Procedure, for which let execution issue.

OPINION PER CURIAM
JONES, ALMON, SHORES AND ADAMS, JJ., CONCUR;
BEATTY, J., CONCURS SPECIALLY;
MADDOX, J., DISSENTS.

Appendix F

IN THE SUPREME COURT OF ALABAMA

NO. 82-536
NO. 82-917

NATIONWIDE MUTUAL INSURANCE COMPANY

APPELLANT

V.

HENRY GERRARD CLAY

APPELLEE

APPEAL FROM THE CIRCUIT COURT FOR THE THIRTEENTH JUDICIAL CIRCUIT OF ALABAMA (MOBILE COUNTY)

ORAL ARGUMENT REQUESTED

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August 15, 1986

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STATEMENT IN SUPPORT OF REQUEST FOR ORAL ARGUMENT

This is a case of unusual magnitude and public interest. The numerous issues include important Constitutional questions. Oral argument in this case is particularly appropriate.

STATEMENT OF THE CASE

CR = Clerk's Record
RT = Trial Transcript

By order dated May 5, 1986, the Supreme Court of the United States vacated this Court's February 8, 1985, affirmance of the trial court's judgment in this case. Remand was ordered "for further consideration in light of *Aetna Life Insurance Co. v. Lavoie*," 106 S. Ct. 1580 (1986). On July 23 the Court directed that this case be rebriefed.

Plaintiff/appellee Henry Gerrard Clay (Clay) filed suit July 14, 1978, against defendant/appellant Nationwide Mutual Insurance Company (Nationwide) for breach of contract, mental anguish, annoyance and inconvenience, seeking $100,000.00 in damages. (CR 1) The contract claim was based upon total disability payments allegedly due from diagnosis of cataracts on August 29, 1977, through 1981 when Clay underwent corrective surgery. (RT 188-90) Nationwide's answer generally denied the allegations of breach and stated "at this time [Nationwide] has still not completed its investigation. . . ." (CR 6)

On September 22, 1978, Nationwide filed a request for production seeking, among other things, Clay's federal and state income tax returns for the previous six

years. (CR 136) Five months later Nationwide filed a motion to compel production, which the trial court granted, allowing Clay 20 days to comply. (CR 136) When Clay failed to produce the documents, Nationwide filed a further motion requesting the trial court to enter a default judgment against Clay. (CR 8) Clay's opposition to that motion stated, "he does not have any federal and state income tax returns in his possession nor does he have any hospital, doctor, or medical records in his possession." (CR 10)

On April 20, 1979, the trial court heard argument on Nationwide's motion for default judgment and ordered that the complaint be dismissed, with prejudice, if Clay did not supply the requested income tax returns within 20 days. (CR 136) On May 3, 1979, Clay's counsel advised that Clay had not filed tax returns during the years requested. Clay's deposition was then taken by Nationwide on May 30, 1979, whereupon Clay first admitted he had not filed income tax returns for the period requested. (CR 136) On March 24, 1980, Clay's original counsel withdrew (CR 13, 15), and on March 28, 1980, Clay's present counsel appeared. (CR 14)

On April 1, 1981, Nationwide propounded interrogatories and requests for production seeking, among other things, some other form of documentation of Clay's income for the years 1970 through 1980. (RT 137) Clay objected and refused to supply the requested information, whereupon Nationwide moved to compel. (CR 137) On January 28, 1982, Clay sought a protective order relative to producing income and earnings information. (CR 138) The trial court granted Clay's motion in part, but ordered him to produce a listing of deposits to his law

office account during the period in question. (CR 138) On February 12, 1982, Clay produced a partial listing of deposits to his law office accounts, for the years 1969 through 1976.

Counsel for Nationwide again deposed Clay on February 22, 1982 (CR 138), at which time Clay refused to answer any questions concerning other disability insurance or his income during the period in question. Nationwide filed another motion to compel, which was granted on March 19, 1982. (CR 138) Clay's deposition was reconvened April 8, 1982, and he responded to some questions relating to his bank accounts and income, but refused to answer questions regarding other disability insurance. On April 19, 1982, Nationwide filed a motion to compel, which was denied seven months later on November 4, 1982, six weeks before trial. (CR 139) On November 29, 1982, only two weeks before trial, Nationwide finally obtained from Clay's bank the remainder of his bank records for January through August, 1977, without which Clay's benefits could not be computed under the clause in his policy providing that his benefits may be prorated depending on his income and other disability insurance (the "Relation of Earnings to Insurance Clause").

Clay, meanwhile, amended his complaint several times. On April 29, 1981, Clay added claims for bad faith and fraud, and increased the punitive damages claim to $1.5 million. (CR 16) He also alleged that Nationwide had made partial payments of $1,300 and $3,900. That amendment was filed two weeks after this Court's initial ruling in *Chavers v. National Security Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981), which recognized a common law action for

bad faith refusal to pay first party claims. Clay's complaint was again amended February 12, 1982, to allege additional facts. (CR 21) Finally, on April 23, 1982, Clay amended to increase the *ad damnum* to $3 million. (CR 21)

Nationwide's answer filed April 27, 1982, admitted the partial payments and included the following defenses:

"*FOURTH DEFENSE*

"The plaintiff's level of earnings was insufficient to allow him to receive the benefits otherwise provided for in the policy by this defendant.

"*FIFTH DEFENSE*

"Any benefits due the plaintiff under the policy of disability insurance issued by this defendant are to be prorated with his other disability insurance policies.

"*SIXTH DEFENSE*

"To obtain this disability insurance policy with the defendant, the plaintiff misrepresented the amount of his income from the practice of law.

"*SEVENTH DEFENSE*

"To obtain this disability insurance policy with the defendant, the plaintiff represented that he would cancel his disability insurance policy with the Paul Revere Insurance Company, but instead of cancelling that policy, the plaintiff increased the amount of coverage under the Paul Revere policy.

* * *

"*NINTH DEFENSE*

"The defendant breached no duty of dealing in good faith owed to the plaintiff.

"TENTH DEFENSE

> "The defendant is not guilty of bad faith in its dealings with the plaintiff and has a lawful basis for ceasing to make disability insurance payments to the plaintiff."

Motions for partial summary judgment by both parties were denied. (CR 46, 50, 58, 140) In his brief in opposition to Nationwide's motion for summary judgment, Clay contended that the Relation of Earnings to Insurance provision should not apply. (*See* Appendix at A-l) Furthermore, Clay asserted his entitlement to full contract benefits, stating in part as follows:

> The plaintiff claims that under their contract he was entitled to $44,910 in total benefits and a premium waiver of $3,652.08 for a total of $48,562.08, not including interest. (*See* Appendix at A-l)

The case went to trial Monday, December 13, 1982. Nationwide's motion for a directed verdict at the close of the plaintiff's case was denied. (CR 64-66; RT 616-617) Nationwide again moved for directed verdict at the conclusion of all the evidence, which motion also was denied. (CR 141; RT 780-81) The Court did later direct a verdict for Nationwide on the fraud claim. (RT 797) Clay's motion for a directed verdict on the contract claim was granted (CR 70; RT 781), and during jury deliberations the contract award was computed by the trial court, with assistance from plaintiff's counsel, in the amount of $46,165. (CR 69-70; RT 781)

The trial court's jury charge stated in part as follows:

> The Court has determined as a matter of law that the Plaintiff is entitled to recover, that the defenses set forth are not substantial in the law, and the facts are undisputed, so the Court's taken that issue away

> and I'll enter an appropriate judgment because the Plaintiff is entitled to recover for the benefits under the contract claim.
>
> The factual dispute in this case, which you must resolve, is whether or not the Defendant, Nationwide Insurance Company, was guilty of bad faith in and about the handling of this claim. Now that is what you must decide. (RT 789)

Nationwide objected to the oral charge. (RT 799-800) After deliberation, the jury returned a verdict on the bad faith claim for $1.25 million, and the court entered a judgment in the amount of $1,296,165.00. (CR 118; RT 802) Nationwide's posttrial motion for J.N.O.V. or new trial was denied (CR 135), and appeal was filed March 14, 1983. (CR 142) Technical clarifications in the record resulted in there being two docket numbers. (CR 148-165)

On February 8, 1985, the judgment below was affirmed. *Nationwide Mut. Ins. Co. v. Clay*, 469 So.2d 533 (Ala. 1985). Nationwide thereafter filed an Application for Rehearing and a Motion for Withdrawal of Opinion and Suggestion of Disqualification, both of which were denied April 5, 1985. 469 So.2d 533, 548. Nationwide's Motion for Stay of Execution of Judgment in the Supreme Court of Alabama was unanimously denied April 16, 1985.

On petition for certiorari in the Supreme Court of the United States, the judgment of February 8, 1985, was stayed by Justice Powell and was later vacated by that Court's order of May 5, 1986, which stated:

> The judgment is vacated and the case is remanded to the Supreme Court of Alabama for further consideration in light of *Aetna Life Insurance Co. v. Lavoie*, 475 U.S. (1986).

Nationwide Mut. Ins. Co. v. Clay, 106 S. Ct. 1942, 90 L. Ed.2d 353 (1986). Clay's application for rehearing was denied June 23, 1986. 106 S. Ct. 3285. Clay thereupon filed a Request for Briefing Schedule and Limitation of Issues on Remand, to which Nationwide has responded. This brief is being filed on or before August 19, 1986, in compliance with this Court's order of July 23, 1986, that "this case is due to be rebriefed."

STANDARDS OF REVIEW

The standard of review in an appeal involving a directed verdict is the "scintilla evidence rule." *See* Ala. R. Civ. Pro. Rule 50; *Turner v. People's Bank*, 378 So.2d 706, 709 (Ala. 1979). The Court "must review the evidence in a light most favorable to the nonmoving party [Nationwide] and if, by any interpretation, the evidence can support any inference supportive of a conclusion in favor of the nonmoving party, directed verdict is inappropriate." *Adams v. Travelers Ins. Co.*, ___ So.2d ___, 20 A.B.R. 2358, 2360 (June 13, 1986). *See also, Nat. Sec. Fire & Cas. Co. v. Vintson*, 454 So.2d 942, 943 (Ala. 1984).

The standard of review on appeal from denial of a motion for J.N.O.V. is whether the jury verdict was plainly erroneous. *Pate v. Sunset Funeral Home*, 465 So.2d 347, 350 (Ala. 1984). However, in bad faith cases, "if the evidence produced by either side creates a fact issue . . . the tort claim must fail and should not be submitted to the jury." *National Sec. Fire & Cas. Co. v. Vintson*, 454 So.2d 942, 944 (Ala. 1984).

The standard of review on appeal from denial of a motion for new trial or remittitur is discussed separately at pp. 57-62.

STATEMENT OF ISSUES ON APPEAL

1. "Bad faith" liability can be imposed only when the insurer had no legally arguable basis for declining to pay the claim in the amount demanded, coupled with actual knowledge of that fact. *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1, 7 (Ala. 1981); *National Sec. Fire & Cas. Co. v. Vintson*, 454 So.2d 942, 944 (Ala. 1984); *Mordecai v. Blue Cross and Blue Shield*, 474 So.2d 95, 98 (Ala. 1985).

2. Undisputed evidence, supported by the trial court's judgment, shows that Nationwide had a meritorious reason for refusing to pay the claim in the *amount* demanded. *Morton v. Allstate Ins. Co.*, 486 So.2d 1263, 1271 (Ala. 1981).

3. Undisputed circumstances reasonably indicate that Clay made material misrepresentations in obtaining the policy. As a matter of law that constituted an arguable basis for refusing to immediately pay the claim. *Ala. Code*, § 27-14-7 (1975); *National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357 (Ala. 1982); *General Acc. Fire & Life Assur. Corp. v. Jordan*, 161 So. 240, 230 Ala. 407 (1935).

4. Undisputed circumstances reasonably indicate that the existence of an ambiguity in the application was a debatable issue. As a matter of law the bad faith claim should not have been submitted to the jury. *Old Southern Life Ins. Co. v. Spann*, 472 So.2d 987, 989 (Ala. 1985).

5. Undisputed evidence shows that Clay refused to submit personal financial data necessary to determine the amount of his claim. As a matter of law that constituted an arguable basis for refusing to pay the amount

demanded. *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1, 4 (Ala. 1981); *Payne v. Nationwide Mut. Ins. Co.*, 456 So.2d 34, 37 (Ala. 1984). *California Cas. Gen. Ins. Co. v. Superior Court*, 173 Cal. App.3d 274, 218 Cal. Rptr. 817 (1985). *Insurance Co. of North American v. Citizensbank of Thomasville*, ___ So.2d ___, 20 A.B.R. 1907, 1912-13 (1986); *Liberty National Life Ins. Co. v. Hale*, 285 Ala. 198, 202, 230 So.2d 526 (1970).

6. Undisputed evidence shows that Nationwide made substantial partial payment of Clay's claim pending resolution of its legally questionable aspects. As a matter of law that satisfied the requirement of good faith in dealing with a legally disputable claim. *Bowers v. State Farm Mut. Auto Ins. Co.*, 460 So.2d 1288, 1290 (Ala. 1984); *Cincinnati Ins. Co. v. Little*, 442 So.2d 891, 894 (Ala. 1983); *National Sec. Fire & Cas. Co. v. Bowen*, 417 So.2d 179, 186 (Ala. 1982); *Sexton v. Liberty Nat. Life Ins. Co.*, 405 So.2d 8, 22 (Ala. 1981).

7. A party to a legally arguable dispute has a right, under the United States Constitution, to access to court to resolve the dispute, and to reasonable opportunity to consult legal counsel in connection therewith. Imposing punitive damages on a party for having declined to pay a legally disputable claim infringes these rights. *Bill Johnson's Restaurants, Inc. v. N.L.R.B.*, 461 U.S. 731 (1983).

8. The $1.25 million punitive award was unreasonably disproportionate and therefore excessive under Alabama law. *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916, 925 (Ala. 1981); *Aspinwall v. Gowens*, 405 So.2d 134, 136 (Ala. 1981); *Roberson v. McCarley*, 259 Ala. 583, 67 So.2d 814 (1953).

9. The $1.25 million punitive award was unreasonably disproportionate and therefore excessive under the United States Constitution, particularly the Fourteenth Amendment and its incorporation of the Excessive Fines Clause, the Contract Clause and the Ex Post Facto Clause. *Marks v. United States*, 430 U.S. 188 (1977).

STATEMENT OF THE FACTS

Henry Gerrard Clay applied for a Nationwide disability income policy December 8, 1976. (RT 219-20; Def.Ex. 2) The application asked, "What is your average earned monthly income?" Clay answered, "$1,800." (RT 37, 218-19) He also represented that an existing $400 per month disability policy with Paul Revere Insurance Company (Paul Revere) would be "replaced" by the Nationwide policy. (RT 198-200) Clay's answers were filled in by the agent, and Clay signed the application. (RT 37, 387-91) As a further part of the application process, Clay submitted to a physical examination by Dr. Herbert Allen. Clay testified he did not remember seeing Dr. Allen, and thought he had seen only a nurse who took a blood sample and some measurements. (RT 44-45) No eye examination was given, but Allen's report indicated no eye problem. (RT 47, 481)

On January 19, 1977, Nationwide issued Clay's policy, which provided a $900 per month benefit after a six-month waiting period. (Def.Ex. 3) For that six-month period, Clay purchased a rider that provided $1,300 per month after a thirty-day waiting period. Clay soon was notified by his Nationwide agent, Bill McDowell, that the policy had been issued but was returned to the home

office for a correction. (RT 49-50) Clay subsequently telephoned the local Paul Revere office and said he wanted to cancel his Paul Revere policy. (RT 56)

On February 4, 1977, Paul Revere agent Leon Adams called on Clay and dissuaded him from cancelling the Paul Revere policy. (RT 447) A question on Clay's Paul Revere application that asked whether any other application was being made for disability insurance was answered, "No." (RT 460) Clay represented to Paul Revere that his income was $65,000 per year, which Clay did not recall. (RT 222, 450) Adams testified he told Clay that Paul Revere would "make over" his existing policy to reflect the increased coverage. (RT 438, 452) Clay denied that. (RT 267) In any event, Clay signed the application and the increased Paul Revere coverage became effective immediately. (RT 451-55)

Clay testified he thereafter attempted to cancel the Nationwide policy by telephoning his Nationwide agent, Bill McDowell. However, McDowell had been transferred, and Clay testified he left word for McDowell to call him and that he intended to tell McDowell he wanted to cancel the policy. (RT 61, 205-06) Nonetheless, Clay continued to pay the premiums on both policies through a monthly bank draft. (RT 202) His combined disability coverage at that point was $3,100. Clay testified he knew he had "too much coverage." (RT 209-10) "It was pretty obvious really that I was not gonna be able to collect on both policies. I mean, you know, I didn't know for sure what the situation would be. I knew I had two policies and it would be nice if I could collect both of them but I had a feeling that I would not be able to collect on both of them." (RT 141)

In March, 1977, Clay received his Nationwide policy, which stated on its cover page as follows:

> A CLAIM UNDER YOUR POLICY COULD BE CONTESTED! PLEASE READ! Your policy was issued based on information entered in your application, a copy of which is attached to your policy. If, to the best of your knowledge and belief, there is any misstatement in the application . . . you should advise the Company regarding the incorrect or omitted information; otherwise a claim under your policy may be contested.

(Def.Ex. 3) Another provision instructed that Clay could cancel the policy for any reason by returning it within 10 days for a full refund of his premiums. (RT 203-04) Clay kept it.

On August 1, 1977, Clay obtained further disability insurance in the sum of $160.60 per month, the amount of Clay's monthly mortgage payment, from National Union Insurance Company in response to a solicitation received by mail from his mortgage company. (RT 206-11) Clay testified that meanwhile, during the spring and summer, he was chronically ill with a low-grade fever and could go to his office only a few hours each day to check his mail. (RT 66-67) He was diagnosed by Dr. Ivey Williamson on April 19, 1977, as having a possible viral infection, but nothing seriously abnormal. (RT 155-56) Clay testified that Williamson examined his eyes and detected no cataract problem. (RT 160-61) Williamson, however, testified that ophthalmology is outside his field of internal medicine; that he conducted no exam for cataracts; and that Clay did not complain about his eyes on that occasion. (RT 161-62)

Clay testified that he was examined by Optometrist Edwin Ross on August 29, 1977, following his recuperation from the illness of several months. (RT 66-69, 77) Ross diagnosed bilateral cataracts. (RT 42, 69, 285-88) Three days later Clay closed his law office and moved his office equipment into a warehouse. (RT 81, 333) On September 7 Clay's condition was confirmed by Ophthalmologist James M. Harrison, to whom Ross had referred Clay. (RT 70)

Clay's initial claim form was submitted September 26, and stated he was disabled from September 7, 1977. However, Clay did not answer two questions on the claim form asking his level of income and whether he carried other insurance. (Pl.Ex. 26; RT 89, 207-08) On the reverse side, Dr. Harrison stated he first examined Clay on September 7 and that Clay's symptoms developed "gradually." (Pl.Ex. 27) Harrison also noted that Clay would be totally disabled "until recovered from surgery."

Clay's claim was erroneously addressed and mailed to Nationwide's group claims office in Atlanta, from where it was forwarded to the individual claims office in Columbus, Ohio. (RT 92-93) There it was assigned to Jim Otey, a claims examiner, on October 20, 1977. (RT 466) From that point forward, there is a sharp difference in the testimony regarding various telephone conversations between Clay and Nationwide. There is also evidence of much confusion on the part of Nationwide due partly to the process of placing Nationwide's claim files on computer, which required temporary removal of the actual files from the claims department. (RT 768-69) As detailed below, there is undisputed evidence that the inability to locate Clay's file resulted in letters and phone messages

not being filed with reasonable promptness which, in turn, resulted in some calls and letters not being answered in a timely manner.

On November 10 and 11, 1977, Clay telephoned Nationwide to inquire about the status of his claim, as evidenced by two telephone memos. (Pl.Ex. 29-30) The second call memo requested that someone "please call him today," but Clay's call was not returned. The call slips were not matched with the file until several days later, as indicated by a notation thereon of "F.N.I.F.," meaning "folder not in file." (RT 478) According to Otey, the receptionist apparently could not locate the file when the calls came in. (RT 478) Clay called twice on November 14 and spoke to Otey. (RT 96-99) Clay testified that during the first call Otey would not find the file to discuss it with him, which Otey denied. (RT 97, 576) In the second conversation Otey informed Clay that Nationwide needed a report from the doctor who diagnosed the cataracts, i.e., Dr. Ross instead of Dr. Harrison. (RT 98)

Upon examining Clay's file in detail on November 15, Otey questioned whether Clay's condition preexisted the effective date of the policy, issued only eight months before the claim. (RT 479-80) He also questioned whether Clay was "totally" disabled. (RT 478) Otey therefore retained Equifax Services to arrange an independent examination to determine the extent of Clay's disability. (RT 488-89, 524-25) Otey also sent Clay some forms to be completed by the physician who diagnosed the cataracts regarding the onset date of the symptoms. (RT 488-89) On November 21 Clay was examined by Dr. Daniel Rencher, an independent ophthalmologist. (RT 492-93)

Nationwide agent Bill McDowell telephoned the home office regarding Clay's claim on November 28 and asked that Otey return the call on November 30, which Otey did. (RT 494) Otey explained that all Nationwide disability claims are contestable in the first two years of a contract and that Nationwide was still examining Clay's claim. (RT 495) McDowell told Otey to "carry on." (RT 495) The next day, December 1, Nationwide received the report of Optometrist Edwin Ross, but it was not matched with Clay's file. (RT 498) Otey therefore did not have Ross' report when Clay called again on December 2. Otey gave Clay's file to a mail supervisor and asked her to check whether any mail had come in for the file. (RT 501) Eleven days later the supervisor reported back, "No mail." (RT 502) On December 16 Nationwide received Dr. Rencher's report, but it, too, was not matched with Clay's file to be given to Otey. (RT 518; Pl.Ex. 38)

Meanwhile, on December 14, 1977, Otey received a call from Hugh Fowler of National Union inquiring about Clay's claim. (RT 505) Otey did not discuss the claim with Fowler on the basis that the information was confidential, and Fowler did not disclose the existence of Clay's policy with National Union. (RT 507)

On December 21, 1977, Clay again telephoned Otey to complain about the delay and the fact that Nationwide was still charging premiums against his checking account. (RT 114) Otey did not have Clay's folder and it was not in the large holding file in the claims department. (RT 515) Otey told Clay he had not yet seen Dr. Rencher's report and made a note to the file to see whether Rencher's report had been received, as evidenced by Plaintiff's Exhibit 41. (RT 114, 515-17) Clay

further testified that Otey asked Clay for the claim number and, when Clay read it aloud with his magnifying glass, Otey said, "Well that proves you can read and we don't owe you any disability." (RT 118) Otey denied that account of the conversation and further denied Clay's testimony that Otey refused to look for Clay's file, that Otey accused Clay of concealing income, that Otey accused Clay of secretly working, and that Otey refused to call Dr. Rencher to check on the report. (RT 117-18; 576-81)

It is undisputed that during the December 21 phone conversation Clay told Jim Otey he had "no other disability income insurance." (RT 122, 581) Clay testified he knew Otey "was being a little bit misled" about the existence of other insurance, "but he (Otey) was misleading himself. (RT 122, 196) Clay further admitted Nationwide was not aware of his Paul Revere policy until six or eight months after the claim. (RT 336) Otey testified he had no knowledge of Clay's other insurance at that point. (RT 579) After the conversation with Clay, Otey received a call from Equifax and requested that they send another copy of Dr. Rencher's report. (RT 522; Pl.Ex. 40)

Clay testified he again called Otey on December 30, but Otey refused to discuss the claim on the basis that the file had been turned over to Nationwide's legal department. (RT 125) Otey had no record or recollection of that call. (RT 525) The second copy of Rencher's report, mailed by Equifax in response to Otey's request, was received by Nationwide on January 4, 1978. (RT 525; Def.Ex. 31) On January 11, Clay called Nationwide agent Bill McDowell and claims attorney John Harker, neither

of whom were in. (RT 125) He also contacted the Alabama Department of Insurance to complain about Nationwide, and about Paul Revere which likewise examined Clay's claim until Clay accepted a settlement on March 16, 1978. (RT 126; 655-56) 0. B. Carr, on behalf of the Insurance Department, wrote to Nationwide inquiring about the status of Clay's claim. (Pl.Ex. 44) That letter was received on January 16. (RT 537, 715, 740)

On January 13, 1978, Otey was still uncertain whether Clay was totally disabled from practicing law. He therefore consulted claims attorney John Harker. (RT 529) The file then contained two versions of Dr. Rencher's report, the first of which indicated Clay had "some" disability but did not say Clay was totally disabled. (RT 528; Def.Ex. 28) Dr. Harrison's report stated that Clay's cataracts developed "gradually," and Dr. Ross' report appeared to indicate Clay's symptoms first appeared "prior to 1977." (Def.Ex. 20; RT 536, 738) However, below the words "prior to 1977" Ross had written "Aug. 29;" and Ross testified he intended only to indicate that Clay's symptoms had developed prior to August 29, 1977, the date of his examination. (RT 308-09)

After discussing Clay's claim, Harker and Otey referred Clay's file to an in-house doctor for opinion on the extent of Clay's disability. (RT 529-31; Def.Ex. 35) The in-house doctor responded that Clay was "not completely and totally unable to perform his usual and customary occupation." (RT 532-33; Pl.Ex. 43) Otey and Harker also discussed the "possibility and probability" that Clay had other disability income insurance. (RT 533) That meeting concluded most of Otey's involvement with Clay's file,

which was thereafter handled mainly by claims attorney John Harker. (RT 579)

On January 16, 1978, Harker again reviewed the reports in Clay's file. (RT 736) Contrary to the in-house doctor's opinion, Harker was convinced Clay was totally disabled from practicing law. (RT 711, 736) However, he believed based upon the reports of Harrison and Ross that Clay's cataract symptoms predated the effective date of the policy. (RT 711, 736-38) Harker thereupon advised Clay by letter of January 16 that the claim could not be honored due to preexisting symptoms, but "as is our customary practice, we are always willing to reconsider any claim based on any additional information." (RT 711; Pl.Ex. 45)

Clay telephoned John Harker on January 17 and 18, but Harker was not in. (RT 128) On January 19 he reached Harker, who explained he had mailed Clay a letter tentatively denying coverage due to preexisting symptoms. (RT 129-33) Upon receipt of Harker's letter that same day, Clay called again and accused Harker of intentionally misreading Dr. Ross' report. (RT 538) Clay stated his condition did not preexist the policy date and that he would get a further report from Dr. Ross confirming that fact. Based on that assurance, Harker authorized a "good faith" rider payment of $1,300, which Clay received. (Pl.Ex. 49; RT 136, 538, 711, 717, 740) Two forms were enclosed with that payment: (1) a continuation of disability form to be completed by Clay, and (2) an attending physician's certification of continuing disability. Clay was instructed to complete and return the forms promptly. (RT 545-48, 742; Pl.Ex. 68)

Clay later called Harker on January 23 to ask if Harker would contact Dr. Ross directly to obtain the requested information. (RT 743-44; 712; Pl.Ex. 52) Meanwhile Harker was contacted on January 23 by Hugh Williams of National Union, who advised that Clay had another disability income policy with Paul Revere in the amount of $2,200 per month. (Def.Ex. 42) Clay called Nationwide on January 30 and left a message for Harker stating, "very important – if you need the doctor's statement call Mr. Clay and let him know or else call Dr. Ross for the information." (Pl.Ex. 54)

Clay testified he next spoke to Harker on January 31, at which time Harker was aware of the Paul Revere policy. Harker said he understood the Paul Revere policy was "issued after the Nationwide policy" and therefore would not affect Nationwide's coverage. However, he was waiting on a letter from Paul Revere to confirm the exact date of issuance. (RT 140; 748)

On February 7, 1978, Harker wrote Dr. Ross, noting that Clay's cataracts developed "sometime prior to August 29, 1977," and asking if Dr. Ross could more accurately determine the onset date. (RT 713; Pl.Ex. 57) Ross responded on February 15 that there had been nothing abnormal when he examined Clay on November 3, 1976, and no "significant impairment of visual acuity until the exam of August 29, 1977." (Pl.Ex. 57) Nationwide received that letter February 23, and Harker wrote instructions on it to pay Clay's sickness disability income. (Pl.Ex. 57; RT 544-45, 717) Otey noticed that the "continuation of disability" forms sent on January 19 had not been returned, initialed Ross' letter with a notation "forms out," and held up the benefits. (RT 545-47, 714-18, 722)

On February 28 Nationwide received a second letter from the Alabama Department of Insurance referring to its earlier inquiry regarding Clay's claim which had not been answered. (Pl.Ex. 58) By letter of March 7 Harker responded by setting forth the history of the claim and stating that Nationwide had made one "good faith" payment of $1,300 while awaiting Clay's return of the continuation of disability forms. Harker further stated: "Immediately upon receipt of that information we will be in a position to bring Mr. Clay's disability payments up-to-date." (Pl.Ex. 62) Meanwhile, on January 31 Nationwide had first received a letter from Paul Revere confirming that Clay owned a Paul Revere disability policy described as a "make over" of the policy issued in 1966. (Pl.Ex. 51) Otey testified that, because the letter did not contain Clay's policy or claim number, it was again stamped "received" on February 16 before being matched with the file. (RT 553) Shortly thereafter, on March 6, Otey wrote Paul Revere advising of Clay's Nationwide coverage. (Pl.Ex. 61)

Although Paul Revere's letter had been received by Nationwide, Harker testified he was not aware that Clay's Paul Revere policy was a make-over of the original policy at the time Harker wrote the insurance department on March 7, 1978. (RT 748) Harker had sent Clay a copy of that letter and upon receiving it on March 9, Clay testified he called Harker to complain. Clay said it was not true that Nationwide was waiting on forms, and that Nationwide was making it look as if he were causing the delay. (RT 149) Clay further threatened to again call the insurance department and to file suit. (RT 151) According to Clay, Harker responded, "If you file suit, you won't get

a nickel for ten years." (RT 151) Harker presented a totally different account of that conversation. (RT 714-716) Harker explained that Nationwide must have a current medical report (within the last 30 days) and agreed to bring payments current to February 7 if Clay would obtain such report using forms Harker was going to send with the payments. (RT 152) Clay agreed, and a further payment in the sum of $3,900 was sent to Clay. Clay took the medical report form to Dr. Ross, who completed and returned it on March 15. (RT 165; Pl.Ex. 67)

Harker made a file note of that March 9 conversation which stated, "Pay another payment to February 7, 1978. He will send forms. I don't believe we can justify a delay since his condition would not improve without surgery. Also suggest we send Equifax now to investigate if office is open." (Pl.Ex. 63) Harker asked that the file be returned to him after the check was mailed. (Pl.Ex. 64-65)

On March 15, 1978, in response to Harker's request that Equifax conduct a follow-up investigation to see if Clay's office was open, Equifax contacted Nationwide and reported that Clay would not sign an authorization releasing his income tax information. (RT 718, 720) Equifax further reported that Clay apparently had not filed a tax return, which raised a question in Harker's mind as to Clay's income level. (RT 724) Harker thereupon advised Clay by letter of March 28, 1978, that "it has come to our attention that there may be certain information which was withheld from us on the application," that Nationwide needed information verifying his income, that a copy of Clay's 1976 tax return would

effectively close the matter, and that "any other information you can provide showing income would be quite beneficial." (Def.Ex. 63; RT 722-24) Harker testified that Clay's income level would affect the amount of benefits due under the Relation of Earnings to Insurance provision in the policy. (RT 724)

According to Harker, Clay never replied to the letter of March 28 and never furnished any information verifying his income as requested. (RT 724) Clay, however, testified he telephoned Harker in April and said he felt it was unreasonable for the company to be requesting income information at that time. Clay further said he could verify his income for 1976 from his office records, but he did not believe that would "close the matter." (RT 171-73) Clay filed suit July 14, 1978. (RT 727)

ARGUMENT

I THE CLAIM SUBMITTED BY THE INSURED WAS LEGALLY ARGUABLE AS A MATTER OF LAW. THE TRIAL COURT THEREFORE ERRED IN SUBMITTING THE BAD FAITH CLAIM TO THE JURY.

A. *"Bad faith" liability can be imposed only when the insurer had no legally arguable basis for declining to pay the claim in the amount demanded, coupled with actual knowledge of that fact.*

This case involves the "first tier" tort of bad faith refusal enunciated in *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1, 7 (Ala. 1981). The plaintiff's burden is to prove the insurer's lack of any legally arguable reason for refusing to pay, coupled with actual knowledge of that fact. Unless the plaintiff can demonstrate his entitlement to a directed verdict on the underlying contract claim, it is error to even submit the bad faith claim to the jury.

National Sec. Fire & Cas. Co. v. Vintson, 454 So.2d 942, 944 (Ala. 1984). The plaintiff therefore must prove the insurance company failed to produce a scintilla of evidence supporting any legal defense to the plaintiff's contract demand. *See* Ala. R. Civ. Pro. Rule 50(e).

This Court has long held as a matter of law that sloppy handling and poor judgment do not constitute "bad faith." *See Blue Cross and Blue Shield v. Granger*, 461 So.2d 1320, 1327 (Ala. 1984); *Independent Life & Acc.* Ins. Co. v. Parker, 449 So.2d 233, 237 (Ala. 1984); *Prudential Ins. Co. v. Coleman*, 428 So.2d 593, 598 (Ala. 1983); *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d at 5; *Calvert Fire Ins. Co. v. Green*, 278 Ala. 673, 180 So.2d 269 (1965). Furthermore, as a matter of law, partial payment of a disputable claim precludes a finding of "bad faith" refusal to pay. *See Bowers v. State Farm Mut. Auto Ins. Co.*, 460 So.2d 1288, 1290 (Ala. 1984); *Cincinnati Ins. Co. v. Little*, 442 So.2d 891, 894 (Ala. 1983); *National Sec. Fire & Cas. Co. v. Bowen*, 417 So.2d 179, 186 (Ala. 1982); *Sexton v. Liberty Nat. Life Ins. Co.*, 405 So.2d 8, 22 (Ala. 1981).

Questions as to (1) the amount of benefits owed under a policy, (2) the existence of an ambiguity in the application, (3) the existence of a misrepresentation by the insured, and (4) the insured's failure to cooperate in providing requested information, all have been held to constitute legally arguable questions of law and fact that preclude an award of extracontractual damages for the tort of "bad faith" refusal to pay. *See Morton v. Allstate Ins. Co.*, 486 So.2d 1263, 1271 (Ala. 1986) (Uncertainty as to amount of liability); *Old Southern Life Ins. Co. v. Spann*, 472 So.2d 987, 989 (Ala. 1985) (ambiguity in the application); *National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357,

1361 (Ala. 1982) (misrepresentation in application); *Payne v. Nationwide Mut. Ins. Co.*, 456 So.2d 34, 37 (Ala. 1984) (lack of cooperation in furnishing necessary information).

Each of those circumstances or defenses is present in this case, as demonstrated below.

B. *There is undisputed evidence that Nationwide had legally arguable grounds for refusing to pay the claim as submitted by Clay.*

1. Undisputed evidence, supported by the trial court's judgment, shows that Nationwide had a meritorious reason for refusing to pay the claim in the amount demanded.

As recognized in *Morton v. Allstate*, 486 So.2d 1263, 1270-71 (1986), controversies as to the *amount* of loss are debatable reasons for delaying payment, and they entitle the insurer to judgment as a matter of law on the issue of bad faith. In this case it is undisputed that Clay demanded full contract benefits under his Nationwide policy, and that the trial court entered judgment on the contract for less than his demand. The trial court thereby effectively sustained one of Nationwide's legal and factual defenses for refusing to pay the claim in the amount demanded.

In its Amended Answer, Nationwide pled that Clay's earnings were insufficient to allow full benefits under the "Relation of Earnings to Insurance provision in Clay's policy and that any benefits due were to be prorated with his other disability policies. (CR 44) However, in opposition to Nationwide's introduction of evidence showing Clay's income and other insurance, Clay filed a motion in limine asserting that such evidence was irrelevant and

immaterial to the issues. (CR 26) Furthermore, in response to Nationwide's motion for partial summary judgment, Clay argued his entitlement to full contract benefits as follows:

> The Plaintiff claims that under their contract he was entitled to $44,910 in total benefits and a premium waiver of $3,652.08 *for a total of $48,562.08*, not including interest. (emphasis added)

See Appendix A-1.[1] The trial court awarded $46,165 by computing the contract amount, with help from Clay's counsel, under the Relation of Earnings to Insurance Clause. With prejudgment interest at six percent from the date each payment was due, the contract total would have exceeded $50,000 on the day of trial.

The award of an amount less than Clay's contract demand demonstrates Nationwide had a legal and factual defense for refusing to pay the claim in the amount demanded. *Cf. First State Ins. Co. v. Wallace*, Slip opinion No. 83-7206 (11th Cir. March 6, 1984). (A copy of that unpublished slip opinion is reproduced at Appendix A-2) The bad faith claim therefore should not have been submitted to the jury. *See National Sec. Fire & Cas. Co. v. Vintson*, 454 So.2d 942, 944 (Ala. 1984).

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[1] Clay's reply brief was part of the trial court record, but was not included in the record on appeal. It may be incorporated into the record on appeal under Rule 10(f) if the Court deems it necessary.

2. Undisputed circumstances reasonably indicate that Clay made material misrepresentations in obtaining the policy. As a matter of law that constituted an arguable basis for refusing to immediately pay the claim.

An insurance company has a right to litigate the existence of misrepresentations in an application, without fear of punitive damages, so long as there is a reasonably arguable basis for putting the misrepresentation question in issue. The fact that the issue is ultimately resolved adversely to the insured does not negative that such an issue existed in the first place. In this case, undisputed circumstances reasonably indicate Clay made material misrepresentations in the application regarding his income and other disability insurance. Furthermore, Clay arguably made a further misrepresentation upon receipt of his Nationwide policy by failing to correct information that was undisputedly wrong. *Cf. National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357 (Ala. 1982). Such misrepresentations void the policy, even if they are made innocently. *Ala. Code* § 27-14-7 (1975). *See also, National Sav. Life Ins. Co. v. Dutton*, 419 So.2d at 1361. Nationwide adduced at least a scintilla of evidence to support these arguments, rendering improper the directed verdict on the contract claim. However, even if the trial court were correct in entering a directed verdict on the contract claim, until then the misrepresentation defenses were reasonably arguable, and Nationwide was entitled to debate them.

There was undisputed evidence that, in obtaining the disability policy, Clay made statements concerning his income that reasonably appeared to Nationwide to be misrepresentations. On the application, signed December

8, 1976, Clay represented his "average earned monthly income" as $1,800. (Def.Ex. 2) Clay's bank deposits to his law office account for 1976 showed his total *gross* receipts that year were $26,714.41. (RT 228; Def.Ex. 66) Subtracting Clay's monthly office overhead of $900 yields a gross income of less than $15,000 per year, which is at least 25 percent less than he represented. (RT 229-34, 614) The subtraction of Clay's overhead costs comports with this Court's holding in *General Acc. Fire & Life Assur. Corp. v. Jordan*, 161 So. 240, 230 Ala. 407 (1935), that reimbursement of business expenses is not part of one's earnings for purposes of obtaining disability income insurance. 161 So. at 242. *See also, Day v. Mutual of Omaha*, 534 S.W.2d 859 (Tenn. App. 1975). On similar facts, the insured in *Jordan* was held to have misrepresented, as Clay did, his earnings and the existence of other insurance.

While Clay disclosed the existence of a $400 per month disability policy with Paul Revere, he represented that he would "replace" it with the Nationwide policy if approved. It is undisputed, moreover, that after being informed the Nationwide policy was approved, Clay instead increased his Paul Revere coverage to $2,200 per month. (RT 50, 56-60; 433-47) Clay did telephone Paul Revere's office in Mobile to say he wanted to cancel the old policy (RT 56), but it is undisputed that a Paul Revere agent subsequently dissuaded him from doing so and sold him the increased amount. (RT 56-60; 433-34) Furthermore, it was undisputed that the original Paul Revere policy was never actually cancelled, but was "made over" into the $2,200 per month policy. (RT 452-53; 659-60) Clay's testimony that he was unaware of the "make over"

is contradicted by the Paul Revere agent, who said he told Clay the old policy would be made over. (RT 438, 452) The essential fact, however, is that the Paul Revere policy was not "replaced" as Clay represented it would be.

A further misrepresentation occurred when Clay received his Nationwide policy, which contained the following warning on its cover:

> A CLAIM UNDER YOUR POLICY COULD BE CONTESTED! PLEASE READ! Your policy was issued based on information entered in your application, a copy of which is attached to your policy. If, to the best of your knowledge and belief, there is any misstatement in the application . . . you should advise the Company regarding the incorrect or omitted information; otherwise a claim under your policy may be contested.

It is undisputed that when Clay received the Nationwide policy containing that warning, he had already increased his Paul Revere coverage. However, Clay failed to notify Nationwide that he did not "replace" the Paul Revere policy as represented in the application. Under the principle recognized in *National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357 (Ala. 1982), that even an innocent misrepresentation is sufficient to void coverage, Clay's failure to correct the application was a misrepresentation that barred recovery under the contract. It certainly was an arguable defense entitling Nationwide to a directed verdict on the issue of bad faith.

Materiality of Clay's representation that he would "replace" the Paul Revere policy may be inferred from the fact that it is a continuing declaration to the policy. *See* Couch, Insurance 2d, § 37:394 (1961). That inference is

buttressed by undisputed testimony from Nationwide's underwriter that Clay's policy would not have been issued in the face amount if Clay had not represented the Paul Revere policy would be replaced. (RT 664-83) The statute on misrepresentation voids coverage regardless of whether the misrepresentation is innocent or willful. Ala. Code § 27-14-7 (1975).

Clay's income representations likewise were material because the company actually insured a percentage of Clay's income. (RT 664-68) Overinsurance encourages one to prolong his disability, thereby increasing the company's risk. *See Day v. Mutual of Omaha*, 534 S.W.2d 859 (Tenn. App. 1975). Clay's increased monthly benefit with Paul Revere of $2,200, combined with his $900 per month Nationwide coverage, far exceeded the $1,800 represented as his income.

In addition to the misrepresentations discussed above, it is undisputed that Clay failed to answer questions on his claim form concerning his income and other insurance. (Pl.Ex. 26) It is further undisputed that Clay later told Nationwide's claims examiner that he had no other insurance. (RT 122, 581) That was an intentional misstatement. At the time it was made, Clay had submitted a claim to Paul Revere for a $2,200 monthly benefit. (RT 624) Nationwide's reasonable suspicions regarding Clay's income and other insurance were only reinforced by his subsequent refusal to provide income information.

The directed verdict by the trial court is contrary to the standard that all inferences be construed in favor of the nonmoving party under the scintilla evidence rule. If there was to be a directed verdict on the contract claim, it

should have been for Nationwide. The essential fact is that regardless of Clay's intentions, he undisputedly failed to comply with his commitment to Nationwide to cancel his existing coverage. That failure, willful or otherwise, constituted grounds for voiding coverage under Ala. Code § 27-14-7 (1975). When Clay received his Nationwide policy and failed to correct that information, his misrepresentation was compounded. *See National Sav. Life Ins. Co. v. Dutton, supra.* At least that constituted a fact question for the jury.

At the very least it was a legally arguable issue, precluding a finding of bad faith.

> 3. Undisputed circumstances reasonably indicate the existence of an ambiguity in the application was a debatable issue. As a matter of law, the bad faith claim should not have been submitted to the jury.

As recently confirmed in *Old Southern Life Ins. Co. v. Spann*, 472 So.2d 987, 989 (Ala. 1985), an insurance company is legally entitled to debate the existence of an ambiguity in the policy without subjecting itself to "bad faith" damages if the issue is ultimately resolved in favor of the insured. Under a reasonably arguable meaning of the phrase "average earned monthly income" in Nationwide's application, Clay misrepresented his income in obtaining the policy. At trial Clay contended that phrase meant his gross law office receipts (RT 234-41), whereas Nationwide adduced written evidence of the parties' intent that it meant Clay's gross income after payment of his overhead. (See Pl.Ex. 13 at p. 419) *See also, General Acc. Fire & Life Assur. Corp. v. Jordan, supra* pp. 33-34. For

example, the Nationwide Agent's Portfolio (Pl.Ex. 13 at p. 419) defined "earned income" as:

> "1. Income before taxes arising from an occupation, or
>
> "2. Net income, after expenses, but before taxes, arising from the operation of a business."

Nationwide's further evidence of the parties' intent was foreclosed by the trial court before Nationwide presented its case, in sharp derogation of the directed verdict standard. (RT 234-43)

The mere fact that adverse parties contend for different constructions does not of itself force a conclusion that disputed language is ambiguous. *Antram v. Stuyvesant Life Ins. Co.*, 291 Ala. 716, 720, 287 So.2d 837 (1973). There are numerous cases holding in favor of insurance companies with respect to questions of ambiguity. *See, e.g., Smith v. Kennesaw Life & Acc. Ins. Co.*, 284 Ala. 12, 221 So.2d 372 (1969); *Maryland Cas. Co. v. Allstate Ins. Co.*, 281 Ala. 671, 207 So.2d 657 (1968); *Canal Ins. Co. v. Stidham*, 281 Ala. 493, 205 So.2d 516 (1967); *Trinity Univ. Ins. Co. v. Stapp*, 278 Ala. 209, 177 So.2d 102 (1963). Furthermore, as the Court has often observed, the "polestar" of all rules of construction is the intent of the parties, which is a fact question for the jury. *Smith v. Kennesaw Life & Acc. Ins. Co.*, 284 Ala. at 18. The existence of an ambiguity was legally debatable, and Nationwide was entitled to a jury determination of the parties' intent.

> 4. Undisputed evidence shows that Clay refused to submit personal financial data necessary to determine the amount of his claim. As a matter of law that constituted an arguable basis for refusing to pay the amount demanded.

The duty of good faith and fair dealing is mutual. *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1, 4 (Ala. 1981). Hence, the insured's failure to cooperate in furnishing information necessary to a determination of coverage precludes any tort action for the company's refusal immediately to pay the amount demanded. *See Payne v. Nationwide Mut. Ins. Co.*, 456 So.2d 34, 37 (Ala. 1984). That principle has been described as the doctrine of "comparative bad faith." *See, e.g., California Cas. Gen. Ins. Co. v. Superior Court*, 173 Cal. App.3d 274, 218 Cal. Rptr. 817 (1985).

It is difficult to conceive of a scenario that presents a more suspicious disability claim than the one submitted by Clay. The fact that seven months after the policy was issued Clay claimed he was totally disabled by cataracts, which normally develop gradually over a period of years (RT 290, 313), justified Nationwide's initial suspicions that the disability either preexisted or was not total. Even though Nationwide ultimately resolved its suspicions in Clay's favor and made substantial partial payments, such fact does not lessen the company's right to examine the circumstances of the claim.

When Nationwide learned that Clay also owned a $2,200 per month benefit with Paul Revere, it reasonably became suspicious as to the amount of Clay's income. He had represented his monthly income as only $1,800. Furthermore, upon investigation Nationwide learned that Clay refused to authorize release of his income tax records, and that he possibly had not filed tax returns since 1975.[2] Nationwide also had a health application

[2] It was not until May 3, 1979, that Clay confirmed he had not filed tax returns for the years requested. Even as late as

(Continued on following page)

signed by Clay in January, 1976, which represented Clay's income as $1,000 per month. (Def.Ex. 1) Those facts raised legitimate questions as to possible misrepresentation, overinsurance, and amount of coverage. Nationwide had already paid $5,200 under a six month waiting period rider, but the actual disability policy contained a "Relation of Earnings to Insurance" provision that prorates an insured's benefits according to his income and other insurance.

By letter of March 28, 1978, Nationwide claims attorney John Harker advised Clay "it has come to our attention that there may be certain information which was withheld from us on the application." Harker requested income verification, stating that a copy of Clay's 1976 tax return would close the matter but that "any other information you can provide showing income would be quite beneficial." (Def.Ex. 63; RT 722-24) Clay flatly refused to provide either a tax return or other verifying income information, which only reinforced Nationwide's suspicions. Clay testified he told Nationwide it would be easy for him to verify his income for 1976 but he refused to do so because he did not believe it would "close the matter." (RT 171-73) Without that information it was impossible to determine whether Clay had sufficient income to support full coverage under the policy, considering he also had a $2,200 benefit with Paul Revere.

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March 6, 1979, Clay stated he had not produced any tax returns in response to Nationwide's request for production "because he does not have any federal and state income tax returns in his possession. . . ." (CR 10)

This issue underscores the importance of the fact question regarding the amount of Clay's income, which was relevant in two ways. First, as previously discussed, proof of Clay's income was essential to a determination of whether Clay, in obtaining the policy, misrepresented his income. Second, Clay's income was a necessary element of his contract claim, which Clay had the burden of proving. As a condition to asserting the tort of bad faith, Clay's burden was not simply to prove the amount of his income at trial, but to demonstrate it unequivocally *before* trial upon submission of his claim. At no time, however, did Clay submit intelligible information on what his income was. The only evidence ever produced of Clay's income were the bank records of gross deposits to his law office account. (The insurance, however, was on Clay's income – his take home pay – not on his law office's gross receipts. At no time did Clay ever prove his take home income vis-a-vis his law office gross deposits.) The bank records of Clay's gross law office deposits were obtained only by subpoena, over Clay's objection and motion for protective order. Furthermore, it is undisputed that not until two weeks before trial did Nationwide see all of those records. The issue of Clay's income, which he had the burden of establishing *before* trial, was at least a fact question for the jury.

Nationwide had reasonable grounds for suspicion based upon the undisputed circumstances before it at the time the request for income information was made. The fact that the trial court directed a verdict based on evidence later developed during discovery does not create a question of "bad faith," as acknowledged in *Insurance Co. of North America v. Citzensbank of Thomasville*, ___ So.2d

___, 20 A.B.R. 1907, 1912-13 (1986). Nationwide had a reasonable basis to question the amount of coverage owed. Its attempt to investigate further by requesting substantiation of Clay's income is not a basis for a bad faith cause of action. Otherwise the Court is rewarding the wrongdoer and the uncooperative insured who violates his good faith duty to provide the company with "all material information" bearing upon coverage. *Liberty National Life Ins. Co. v. Hale*, 285 Ala. 198, 202, 230 So.2d 526 (1970).

This Court in *Continental Ins. Co. v. Kountz*, 461 So.2d 802 (Ala. 1984), criticized the insurer for not taking sufficient steps to investigate the claim presented to it. In this case, Nationwide's efforts to investigate Clay's claim were thwarted by his own refusal to furnish information. If an insurance company denies a claim without taking sufficient steps to investigate it, it violates its responsibility to other insureds. *See Vincent v. Blue Cross-Blue Shield*, 373 So.2d 1054, 1064 (Ala. 1979) (Jones, J. concurring). However, if the company tries to carry out that responsibility by investigating a plainly doubtful claim, under the trial court ruling it is subject to punitive damages. An insurance company must have a right to withhold further benefits when the insured fails to cooperate in providing requested information sufficient to substantiate the claim. Otherwise, the insurer's only practical course is to pay every claim submitted no matter how suspect.

5. Undisputed evidence shows that Nationwide made substantial partial payment of Clay's claim pending resolution of its legally questionable aspects. As a matter of law that satisfied the

requirement of good faith in dealing with a legally disputable claim.

Nationwide had reasonable grounds for initially questioning the circumstances of Clay's disability claim involving cataracts, which normally develop over a period of years. Those questions eventually were resolved in Clay's favor, but not before several months passed in which Nationwide sought to obtain the various medical reports needed for a determination of coverage. Much of that delay resulted from Nationwide's own administrative problems, as Nationwide has readily admitted. (RT 767-69) Nonetheless, it is undisputed that Nationwide sent Clay four $1,300 payments under a six-month rider while the claim was pending. That total of $5,200 brought Clay's benefits current through February 7, 1978. (RT 716).

In at least four cases this Court has held that substantial payment of a claim pending resolution of any questionable aspect is prima facie evidence of good faith and entitles the insurer to judgment as a matter of law on the plaintiff's claim of "bad faith refusal." *Bowers v. State Farm Mut. Auto Ins. Co., supra; Cincinnati Ins. Co. v. Little, supra; National Sec. Fire & Cas. Co. v. Bowen, supra; Sexton v. Liberty Nat. Life Ins. Co., supra.* As in those cases, it is undisputed here that Nationwide did pay a substantial portion of Clay's claim. Clay therefore failed to establish the prima facie element of bad faith "refusal." Furthermore, there was undisputed evidence supporting the inference that it was not Nationwide's breach that resulted in the suspension of further payments, but Clay's refusal to furnish information necessary to a determination of coverage.

II A PARTY TO A LEGALLY ARGUABLE DISPUTE HAS A RIGHT, UNDER THE UNITED STATES CONSTITUTION, TO ACCESS TO COURT TO RESOLVE THE DISPUTE, AND TO REASONABLE OPPORTUNITY TO CONSULT LEGAL COUNSEL IN CONNECTION THEREWITH. IMPOSING PUNITIVE DAMAGES ON A PARTY FOR HAVING DECLINED TO PAY A LEGALLY DISPUTABLE CLAIM INFRINGES THOSE RIGHTS.

The imposition of substantial punitive damages for asserting nonfrivolous legal and factual defenses infringes the right of access to court and of seeking assistance of counsel. In *New York Times v. Sullivan*, 376 U.S. 254 (1964), and *Gertz v. Robert Welch, Inc.*, 418 U.S. 323 (1974), the Supreme Court of the United States held that punitive damages are impermissible where their effect is to chill exercise of the right of free speech protected by the First Amendment as incorporated by the Fourteenth Amendment. That same principle should protect a civil litigant's rights to access to court and to consultation with counsel, rights also protected by the Fourteenth Amendment. A civil litigant has a right to assert reasonably arguable legal or factual defenses, notwithstanding that those defenses ultimately are not sustained. The Constitutional right to present those defenses without fear of retribution must be preserved.

The guarantee of equal and open access to the courts derives from Constitutional principles of due process, equal protection, and the right of petition. In *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972), the Court stated that the right of access to the courts is an aspect of the First Amendment right to petition the government for redress of grievances. *Id.* at

510. *See also, Sure-Tan, Inc. v. N.L.R.B.*, 467 U.S. 883 (1984); *Bill Johnson's Restaurants, Inc. v. N.L.R.B.*, 461 U.S. 731, 741 (1983). Additional guarantees are afforded under the Fourteenth Amendment, which protects civil litigants who seek recourse in the courts, either as defendants hoping to protect their property or as plaintiffs attempting to redress grievances." *Logan v. Zimmerman*, 455 U.S. 422, 429 (1982). *See also, Silver v. Cormier*, 529 F.2d 161, 163 (10th Cir. 1976).

Due process requires the right of access to court to defend against ligitation, *Collex, Inc. v. Walsh*, 394 F. Supp. 225 (1972), and encompasses the right to seek judicial resolution of grievances without punishment. *See Laaman v. Perrin*, 435 F. Supp. 319 (D.N.H. 1977). To punish a litigant for exercising such a Constitutional right is a Due Process Violation. *See In re Lewallen*, 23 Ca1.3d 274, 590 P.2d 383, 152 Cal. Rptr. 528 (1979). While assertion of insubstantial claims are not protected, "if there is a genuine issue of material fact that turns on the credibility of witnesses or on the proper inferences to be drawn from undisputed facts," assertion of the claim is protected under the First Amendment. *See Bill Johnson's Restaurants v. N.L.R.B.*, 461 U.S. at 743-45.

The $1.25 million punitive damage award against Nationwide impaired its Constitutional right to assert reasonably arguable legal and factual defenses in this case. It effectively chills the right of insurance companies, and indeed all civil defendants, to assert legitimate defenses to questionable claims. The contract defenses presented here, especially the misrepresentation issues, turned on the credibility of witnesses and the proper

inferences to be drawn from the facts. Moreover, Nationwide's defense to the *amount* of Clay's demand not only was meritorious; it was effectively sustained in determining the amount due on the contract. Under the First and Fourteenth Amendment guarantees recognized in *Bill Johnson's Restaurants v. N.L.R.B., supra,* Nationwide had a right to assert those defenses without incurring such punishment.

Nationwide's right of equal access to court was further undermined by the line of Alabama cases holding that punitive damages for bad faith breach of contract may be awarded only in cases involving insurance contracts. *See, e.g., Gaylord v. Lawler Mobile Homes, Inc.,* 477 So.2d 382 (Ala. 1985); *Garvin v. Shewbart,* 442 So.2d 80 (Ala. 1983); *Sprowl v. Ward,* 441 So.2d 898 (Ala. 1983); *Kennedy Electric v. Moore-Handley, Inc.,* 437 So.2d 776 (Ala. 1983). The isolation of insurance companies in that manner is not reasonably tailored to achieve any rational state purpose, especially where there is already a prescribed legislative remedy providing extracontractual damages for the nonpayment of insurance benefits. *See* Ala. Code § 27-1-17 (1975). The Supreme Court of Alabama has encroached on the legislature's function by carving out a narrow common law punitive damages remedy available only to plaintiffs who sue insurance companies. In principle, and as applied here, the Alabama "common law" remedy for bad faith against insurance companies violates the Equal Protection Clause of the Fourteenth Amendment.

III THE AMOUNT OF $1.25 MILLION IN PUNITIVE DAMAGES IMPOSED BY THE COURT WAS UNREASONABLY DISPROPORTIONATE TO ACTUAL DAMAGES, AND THEREFORE EXCESSIVE, ACCORDING TO STANDARDS ESTABLISHED BY ALABAMA LAW AND BY THE UNITED STATES CONSTITUTION.

A. *The award was unreasonably disproportionate and therefore excessive under Alabama law.*

1. Punitive damages may not be awarded for bad faith without proof of "evil motive" on the part of the insurance company.

Under Alabama law, proof of the prima facie objective elements of the tort of bad faith, without more, entitles the plaintiff to recover only compensatory damages. *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916, 925 (Ala. 1981). Such damages may include mental distress and economic loss, but not punitive damages. *Id.* To trigger punitive damages, a defendant "must not only intentionally have breached his duty of good faith;" he must also have acted "with malice, willfulness, or wanton and reckless disregard" of the rights of the plaintiff. *Id.* A plaintiff seeking punitive damages must therefore go beyond merely proving the defendant lacked any legal or factual defense coupled with actual knowledge of that fact; he must additionally prove that the defendant meant harm to the plaintiff by denying the claim. This higher standard of proof has been required since the tort of bad faith was first recognized, although, in more recent cases, the Court has not emphasized it.[3]

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[3] The desire has been expressed by some members of the Court for a nonpunitive remedy whereby the plaintiff may

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The Alabama requirement for punitive damages is not dissimilar to one recently embraced in Arizona, a leading bad faith jurisdiction. *See Linthicum v. Nationwide Life Ins. Co.*, ___ P.2d ___ (Ariz. July 23, 1986). A copy of that slip opinion is reproduced in Appendix C. Upon surveying the various characterizations of conduct warranting punitive damages, the Supreme Court of Arizona adopted the following approach:

> We . . . conclude that a less broad standard for punitive damages is needed. As discussed earlier, it is the "evil mind" that distinguishes action justifying the imposition of punitive damages. * * * In whatever way the requisite mental state is expressed, the conduct must also be aggravated and outrageous. It is conscious action of a reprehensible character. The key is the wrongdoer's intent to injure the plaintiff or his deliberate interference with the rights of others, consciously disregarding the unjustifiably substantial risk of significant harm to them. * * * While the necessary "evil mind" may be inferred, it is still this "evil mind" in addition to outwardly aggravated, outrageous, malicious, or fraudulent conduct which is required for punitive damages. We hold that before a jury may award punitive damages there must be

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recover compensatory damages for economic loss and mental distress in addition to the amount of the contract claim. *See, e.g., Continental Assur. Co. v. Kountz*, 461 So.2d 802, 810 (Ala. 1985) (Torbert, C. J., concurring in the result and Maddox, J., dissenting). As demonstrated in this section, such a remedy already exists under the Court's decision in *Gulf Atlantic Life Ins. Co. v. Barnes, supra*, which recognizes compensatory recovery for bad faith.

> evidence of an "evil mind" and aggravated and outrageous conduct. Slip op. at 13-14. (citations omitted)

Although the defendant insurance company in *Linthicum* was found to have acted in its own interest knowing that denial of the claim would harm the plaintiff, the court reversed the punitive award, stating that absent evidence of a "deliberate ignoring of the Linthicums' rights and needs," the above standard had not been met. Slip op. at 16-17; *See also, Rawlings v. Apodaca*, ___ P.2d ___ (Ariz. July 22, 1986) (merely proving intentional conduct is not sufficient).

In this case Nationwide did not dispute that Clay's claim was poorly handled, although how badly it was handled was in dispute. There was no evidence, however, from which the jury could reasonably have concluded that Nationwide deliberately or maliciously attempted to harm Clay, or acted with wanton and reckless disregard, knowing that its conduct was likely to cause him significant harm. The punitive damage award is therefore contrary to the *Barnes* standard and must be reversed.

Furthermore, as in *Linthicum, supra*, this Court should embrace the standard whereby punitive damages, at least in bad faith actions, are allowed only upon "clear and convincing" proof of an "evil mind." The Arizona court noted that because such damages are an extraordinary remedy, a more stringent standard of proof is necessary and appropriate. Slip op. at 14. A higher standard is all the more necessary in Alabama, where a bad faith breach of contract action is available only in noncommerical first party actions against insurance companies. (See Part II, *supra*.) Singling out insurers in that fashion exposes them to substantial punitive damage awards,

necessitating a higher burden of proof commensurate with the increased exposure.

The absence of any proof, clear and convincing or otherwise, that Nationwide maliciously intended to harm Clay requires reversal of the $1.25 million bad faith judgment.

2. The $1.25 million punitive award was excessive under existing statutory and common law standards in Alabama.

Under Alabama law, a trial court's refusal to grant a remittitur is largely discretionary and will not be reversed unless the trial court "abused its discretion" in so ruling. *General Motors Corp. v. Edwards*, 482 So.2d 1176, 1198 (Ala. 1985). If the record discloses that the jury verdict resulted from some improper motive (bias, passion or prejudice) or through a mistaken view of the merits, the appellate court has a duty to order a remittitur. *Aspinwall v. Gowens*, 405 So.2d 134, 136 (Ala. 1981); *Airheart v. Green*, 267 Ala. 689, 693, 104 So.2d 687, 690 (1958). In determining whether those circumstances are present, the appellate court need not search for any particular wrongful influence or failure of duty in the jury's consideration of the case. *Alabama Gas Co. v. Jones*, 244 Ala. 413, 13 So.2d 873, 876 (1943). A comparison of the verdict to the evidence at trial "usually furnishes the determining data." *Id.* Furthermore, it is appropriate to examine the verdicts of similar cases, and, "if the amount of a verdict is much above or greatly below the average, it is fair to infer, in the absence of extraordinary features, that some improper motive has led the jury astray." *Alabama Power Co. v. Smith*, 273 Ala. 509, 142 So.2d 228, 245 (1962).

The punitive award against Nationwide is nearly 12½ times greater than the only other "first tier" verdict affirmed by this Court since the tort of bad faith was recognized. *See Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981). In *Barnes*, wherein the insurer tried to "cover up" its mistake without any debatable reason, this Court remitted the bad faith verdict from $1.1 million to $100,000 as "excessive and obviously the result of passion and prejudice on the part of the jury." *Id.* at 916. Similarly, in *Aspinwall v. Gowens*, 405 So.2d 134 (Ala. 1981), a $1 million verdict was remitted to $250,000 on the basis that such a verdict would "do injustice in the name of justice." *Id.* at 137. The Court further decided that the evidence did not support a $1 million verdict, and stated as follows:

> ". . . only where the damages allowed are so excessive as to warrant the belief that the jury must have been misled by some mistaken view of the merits of the case should the court interfere and set the verdict aside." *Id.* at 136-37.

As the Court in *Barnes* recognized, the jury's discretion in determining damages "is not absolute." 405 So.2d at 925.

The need for standards in determining whether a discretionary verdict is excessive has been recognized by this Court. *See Hammond v. City of Gadsden*, ___ So.2d ___, 20 A.B.R. ___ (July 11, 1986); *Alabama Farm Bureau Mut. Cas. Ins. Co. v. Griffin*, ___ So.2d ___, 20 A.B.R. 984 (January 17, 1986); *General Motors Corp. v. Edwards*, 482 So.2d 1176 (Ala. 1986). Yet the Court has hesitated to adopt any objective guidelines, preferring instead an *ad hoc* rule whereby each case must be decided on its own facts. *See Yesterday's, Inc. v. Lamey*, ___ So.2d ___, 20 A.B.R. 2426,

2429 (June 20, 1986); *Hammond v. City of Gadsden*, Slip. op. at 11. Nationwide submits that the only standard capable of efficient and evenhanded administration is one that, at a minimum, implies a reasonable relationship between actual and punitive damages. That principle was upheld by the Supreme Court of Alabama in *Roberson v. McCarley*, 259 Ala. 583, 67 So.2d 814, 817 (1953), wherein Justice Simpson stated: "The general rule is that the amount awarded as damages must bear some reasonable relation to the injury sustained and even though there might be a small amount of actual damages to be awarded, the amount allowed as punitive damages should not be disproportionate thereto." Unless the Court adopts an objective standard capable of consistent application at the trial level, it will continue to receive all such damages disputes on appeal and be compelled to decide them itself. *See generally*, Commentary, *Remittitur Practice in Alabama*, 34 Ala. L. Rev. 275, 287-90 (1983).

Due Process requires that actual and punitive damages bear a reasonable relationship to each other. *See generally*, Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 U. Va. L. Rev. 269, 272-78 (1983). Nationwide respectfully submits that the Court should adopt a flexible standard whereby the outer limits of discretionary punitive damages would be determined by the economic measurement the jury places on other damages. The outer measure of punitive damages that reasonably may be imposed would be determined as a multiple of the other damages, for example, three times,[4]

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[4] The multiple of three corresponds to federal antitrust procedures, which suggests that the system would work and that it embodies accepted notions of rightness.

plus a sum that compensates the plaintiff for the costs of prosecuting the claim, notably attorney fees. The jury could be required to render separate verdicts as to actual damages and punitive damages to facilitate administration of this standard.

The approach suggested above affords proper jury discretion while giving trial courts a yardstick for determining excessiveness short of appellate review in every case. Actual damages in a bad faith action can include recovery for economic loss and for mental distress. *See Gulf Atlantic v. Barnes, supra.* These damages, in turn, may be the basis of punitive damages, determined as a limited multiple thereof. Damages so measured will still serve as a deterrent, and yet will be far more susceptible of evaluation by the parties and of administration by the courts. Moreover, the punitive damages award would bear a reasonable relation to actual damages, as required by this Court in *Roberson v. McCarley, supra.*

The punitive award of $1.25 million in the present case is more than 25 times the contract damages assessed by the trial court. Nationwide submits this figure resulted from a "mistaken view of the merits" combined with passion and prejudice on the part of the jury. It is obvious from the record that Nationwide was punished not for maliciously trying to defraud Clay or otherwise harm him, but for its delays in processing the claim. Nationwide never disputed that the claim was poorly handled. However, processing delays and bad judgment do not constitute the tort of bad faith. *See, e.g., Blue Cross & Blue Shield v. Granger, supra; Prudential Ins. Co. v. Coleman, supra.* Furthermore, as discussed in the preceding section, the tort of bad faith does not alone entitle one to recover

punitive damages. The punitive judgment, in the amount awarded, was an aberration that must be corrected as the Court did in *Gulf Atlantic Life Ins. Co. v. Barnes, supra,* and *Aspinwall v. Gowens, supra.*

B. *The award was unreasonably disproportionate and therefore excessive under the United States Constitution, particularly the Fourteenth Amendment and its incorporation of the Excessive Fines Clause, the Contract Clause and the Ex Post Facto Clause.*

The Supreme Court of the United States has held that the Ex Post Facto Clause limits the powers of the legislature but not those of the judicial branch. *See Frank v. Mangum,* 237 U. S. 309 (1915). However, the policy reflected in that clause is "fundamental to our concept of liberty." *Marks v. United States,* 430 U. S. 188, 191 (1977). Persons have a constitutional right to fair warning of conduct that will give rise to punishment, a right protected against judicial infringement by the Due Process Clause of the Fifth and Fourteenth Amendments. *See Marks,* 430 U. S. at 192. In *Marks,* the Court observed that an unforeseeable judicial enlargement of a criminal statute, applied retroactively, operates precisely like an ex post facto law. *Id.* If a state legislature is barred by the Ex Post Facto Clause from passing retroactive laws, "it must follow that a state supreme court is barred by the Due Process Clause from achieving precisely the same result by judicial construction." *Id.* While the *Marks* case involved a quasi-criminal statute pertaining to pornography, its rationale applies with equal force to the retroactive creation of remedies providing sanctions by punitive damages.

The punitive assessment against Nationwide in this case was based on a legal standard adopted three years after the alleged misconduct. Throughout the submission of Clay's claim to Nationwide in 1978, Alabama did not recognize tort actions for a company's refusal to immediately pay a claim in the amount demanded. There still was no tort of bad faith when suit was filed July 14, 1978. On May 5, 1981, the Alabama legislature enacted a statute giving a policyholder whose claim is invalidly denied a right of action for the overdue benefits plus a penalty of 1.5 percent per month. Ala. Code § 27-1-17 (1975). Since the Supreme Court of Alabama has held that such statutes may not retroactively apply, the right of action created thereunder could not have been asserted against Nationwide in this case. *See Tyson v. Johns-Manville Sales Corp.*, 399 So.2d 263, 269 (Ala. 1981); *City of Brewton v. White's Auto Store*, 362 So.2d 226, 227 (Ala. 1978). The Supreme Court of Alabama, however, has undertaken what the legislature could not, by creating a new legal standard, upon pain of substantial punitive damages, after the fact of the conduct sought to be redressed. The punitive award is therefore violative of due process law.

The Excessive Fines Clause and Contract Clause, as applied to the states under the Due Process Clause of the Fourteenth Amendment to the United States Constitution, afford additional federal Constitutional protections against the $1.25 million punitive damages award imposed upon Nationwide in the court below. In the interest of brevity and judicial economy, Nationwide adopts the rationale advanced by Aetna Life Insurance Company in its argument of those constitutional issues,

as reproduced in Appendix D of this brief. *See Aetna Life Ins. Co. v. Lavoie*, No. 82-426.

[EXCERPT FROM APPELLANT'S BRIEF OF AETNA LIFE INSURANCE COMPANY IN AETNA LIFE INS. CO. v. LAVOIE, NO. 82-426]

B.

The $3,500,000 Award Is Excessive Under The Excessive Fines Clause Of The Eighth Amendment

For precisely the same reasons and based upon precisely the same comparative punishments which render this award excessive as a matter of Alabama statutory and judge-made law, this award is also excessive under the Excessive Fines Clause of the Eighth Amendment of the United States Constitution. That clause prohibits the imposition of excessive fines, and its history establishes that it is appropriately applied to control the excessiveness of punitive damage awards in civil cases.

In *Solem v. Helm*, 463 U.S. 277, 284-86 (1983). the Supreme Court examined the history of the Eighth Amendment, making clear that the clauses of that amendment are to be interpreted in light of their English antecedents. In *Solem*, the Court held that the concept of proportionality enshrined in the "cruell and unusuall Punishments" provision of the English Bill of Rights of 1689 had been carried over into the Cruel and Unusual Punishments Clause of the Eighth Amendment. Applying the proportionality concept to the case before it, the Court held that the imposition, under a recidivist statute, of a life sentence for the passing of a bad check violated the Eighth Amendment in light of the fact that, *inter alia*,

the State of South Dakota imposed much lighter sentences for more heinous conduct.

As discussed in part IV. A. above, there can be no serious doubt that the $3,500,000 award here is excessive in comparison with punishments established by the Alabama legislature for similar, analogous or more heinous conduct. The only remaining issue, if this Court disagrees with the defendant's state-law challenge to the excessiveness of this award, is whether the Excessive Fines Clause should be interpreted to apply to punitive damage awards in civil cases.

The purposes of punitive damage awards in Alabama are to punish and deter, which are the same purposes as are advanced by the criminal law. When Congress debated the Excessive Fines Clause, there was no suggestion that that clause should be limited in application to criminal proceedings. 1 *Annals of Cong.* 782-83 (Gales & Seaton eds. 1834). The absence of any such suggestion is of special force here, because just prior to that debate, the House had added the words "to criminal cases" to the proposed Fifth Amendment in order to ensure that certain clauses of that proposed amendment would not be applied outside of criminal proceedings. *Id.* at 781-82. The House's failure to add such limiting words to the Eighth Amendment reflects Congress's understanding, confirmed by cases such as *Trop v. Dulles*, 356 U.S. 86 (1958), that the Eighth Amendment applies outside the confines of strictly criminal proceedings.

It is also clear that a punitive damage award is a "fine" under the Eighth Amendment. Punitive damages

were originally awarded under English common and statutory law in civil actions as early as the 13th Century. 2 F. Pollock & F. Maitland, *The History of English Law* 522 (2d ed. 1909). The purposes of punitive damages then, as now in Alabama, were to punish and deter. *Id.* at 519. The size of punitive damage awards was controlled by the Excessive Amercements Clauses of Magna Carta, and the Supreme Court has stated that "[a]n amercement was similar to a modern-day fine." *Solem v. Helm*, 463 U.S. at 284 n.8. Those clauses of Magna Carta "were not hollow guarantees, for the royal courts relied on them to invalidate disproportionate punishments." *Id.* at 285. The Excessive Amercements Clauses clearly came into being as a means of controlling the very passions and prejudices of juries as were present below in this case.

The Excessive Amercements Clauses were subsequently carried over into the English Bill of Rights of 1689, which prohibited "excessive Baile . . . excessive Fines [and] cruell and unusuall punishments." 1 Wm. & Mary, Sess. 2, Ch. 2 (1689). That language was thereafter incorporated directly into Art. I, § 9 of the Virginia Declaration of Rights and into the Eighth Amendment by its Framers. As the Supreme Court has stated:

> "Although the Framers may have intended the Eighth Amendment to go beyond the scope of its English counterpart, their use of the language of the English Bill of Rights is convincing proof that they intended to provide at least the same protection – including the right to be free from excessive punishments."

Solem v. Helm, 463 U.S. at 286. Thus, there is no doubt that punitive damage awards in Alabama are of the same character as civil punitive damage remedies under

English common and statutory law which were limited as to their size by the linear antecedents of the Eighth Amendment. It follows that punitive damage awards in Alabama generally, and the award in this case specifically, must be brought into line with the fines assessed by the Alabama legislature for similar or analogous conduct as discussed in part IV. A. above. Whether the issue of excessiveness is addressed as a matter of Alabama law or the Federal Constitution, the analysis and result are essentially the same: a remittitur of $3,497,000 must be granted in this case by this Court.

C.

The Imposition Of Any Punitive Damages On The Defendant Furthers No State Interest And Violates The Contract Clause And The Due Process Clause Of The Fourteenth Amendment

In its motion for judgment notwithstanding the verdict, TR. 60, 61, the defendant took the position that the "judgment of the jury is against the law of Alabama." As argued in part IV. A. above, the statutory law of Alabama on May 5, 1981 was that an insurance company was liable only for a penalty of one and one-half percent per month on the balance of any wrongfully unpaid health insurance claim. It is thus clear that the decision of this Court in this case on November 5, 1981, necessarily changed the applicable law of Alabama by allowing this case to go to the jury on the bad faith counts. Because the jury has now acted to impose a $3,500,000 punitive damage award on the defendant, the question arises whether the retrospective imposition of this new Alabama "law" can be upheld under the Contract Clause or the Due Process Clause of the Fourteenth Amendment.

(1) *The Contract Clause.* Under the Contract Clause, Art. 1, § 10, cl. 1 of the Federal Constitution, "No State shall . . . pass any . . . . Law impairing the Obligation of Contracts . . . ." If the Alabama legislature, in enacting § 27-1-17 in May of 1981, had instead created a right of action for bad faith and had authorized punitive damage awards as high as $3,500,000, there is virtually no doubt that any attempt by Alabama to impose such an enormous new burden on the contract involved in this case would be held violative of the Contracts Clause. Indeed, in 1978 the Supreme Court struck down under the Contract Clause a Minnesota statute which attempted to impose a less severe burden on a pension fund in language especially sensitive to the realities of the insurance business:

> "These [pension] plans, like other forms of insurance, depend on the accumulation of large sums to cover contingencies. The amounts set aside are determined by a painstaking assessment of the insurer's likely liability. Risks that the insurer foresees will be included in the calculation of liability, and the rates or contributions charged will reflect that calculation. The occurrence of major unforeseen contingencies, however, jeopardizes the insurer's solvency and, ultimately, the insureds' benefits. Drastic changes in the legal rules governing pension and insurance funds, like other unforeseen events, can have this effect."

Los Angeles Dept. of Water & Power v. Manhart. 435 U.S. 702, 721 (1978), *as quoted in Allied Structural Steel Co. v. Spannaus,* 438 U.S. 234, 246-47 (1978).

Under Article IV of the contract at issue in this case, Tr. 344-45, premium rates were to be increased or reduced as "warranted by experience or by reason of any change in factors bearing on the risk assumed." When

this contract was entered in 1967, Alabama recognized no right of action in first-party "bad faith" situations. When the conduct at issue was engaged in by the defendant, there was still no recognition by Alabama of a right to sue and recover punitive damages in a first-party "bad faith" situation. That right did not exist until this Court, almost four years later, recognized such actions in *Chavers, Barnes,* and other cases handed down on November 5, 1981, including this Court's second decision in this case.

Thus, when the contract was entered and performed. neither the defendant nor the plaintiffs had any basis for believing that the contract or existing Alabama law imposed on the defendant the obligation of paying punitive damages for any breach of its contractual obligations.

If, under *Allied Structural Steel Co. v. Spannaus, supra,* Minnesota could not impose on the contract a much less severe ($185,000) burden than the $3,500,000 punitive damage award in this case, then it follows that this award must at the very least be remitted to some level well below $3,500,000 such that the burden of its retrospective imposition on the defendant will pass constitutional muster under the Contract Clause. This is so because, contrary to the suggestion found in the Supreme Court's decision in *Tidal Oil Co. v. Flanagan,* 263 U.S. 444 (1924), the proscriptions of the Contract Clause are applicable to the creation of rights of action by state courts exercising common law power. In short, the word "Law" as found in the Contract Clause must be interpreted to include the recognition of common law rights of action by the state courts.

The Supreme Court has often recognized the relevance of the meaning at English common law of terms used in the Federal Constitution to ascertaining the intent of its Framers, *see, e.g., Schick v. United States*, 195 U.S. 65, 69 (1904). and Solicitor General William Blackstone's *Commentaries* have been singled out as "the most satisfactory exposition of the common law of England." *Id.; see also Ingraham v. Wright*, 430 U.S. 651, 661 (1977). Blackstone's definition of the term "law" included both common law and statute laws:

> "The municipal law of England, or the rule of civil conduct prescribed to the inhabitants of this kingdom, may with sufficient propriety be divided into two kinds; the *lex non scripta*, the unwritten, or common law; and the *lex scripta*, the written, or statute law."

1 W. Blackstone, *Commentaries on the Laws of England* *63 (1765).

In addition, the Framers used phraseology similar to that of the Contract Clause in another provision of the Constitution, the Supremacy Clause, Art. VI, cl. 2, which makes federal law supreme over "anything in the Constitution or Laws of any State." If this reference to the "Laws of any State" had been interpreted in the wooden fashion suggested by the *Tidal Oil* Court, it is easily imaginable that the Supremacy Clause, and therefore federal law, would be frequently subverted. The Supremacy Clause has, of course, been routinely construed to subordinate state common law to superior federal law. *E.g., Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173, 176 (1942).

The available evidence is that the Framers intended no difference between the word "Laws" as it appears in the Supremacy Clause and the word "Law" in the Contract Clause. On August 23, 1787, John Rutledge of South Carolina proposed to amend the Supremacy Clause as it was then drafted as Art. VIII. The Supremacy Clause both as it stood and as Mr. Rutledge proposed it to be amended contained the phrase "laws of the several States." 2 M. Farrand, *The Records of the Federal Convention of 1787*, 183, 389 (1911). On August 28, 1787, Mr. Rutledge, at the close of the only recorded substantive debate on the Contract Clause, proposed to insert the phrase "nor pass bills of attainder nor retrospective laws" into what was then Art. XII to embody the principle of the Contract Clause. *Id.* at 440. It must be assumed that Mr. Rutledge, a key figure in the consideration of both the Supremacy and Contract Clauses, used the word "Law" with a consistent meaning.

(2) *The Due Process Clause of the Fourteenth Amendment*. As the defendant has argued above, the punitive damage award in this case cannot be upheld under current Alabama bad faith law as enunciated by this Court. Defendant further submits that the imposition of any punitive damage award in this case violates the Due Process Clause of the Fourteenth Amendment because it confiscates a large amount of the defendant's property and transforms it into an extraordinary monetary windfall to the plaintiffs. The occasion for doing so is punishment for acting inconsistently with a substantive rule of conduct which was itself nonexistent in Alabama when the acts of which the plaintiffs complain took place.

Punitive damages are, almost by definition, arbitrary, capricious, severe and whimsical. It is therefore not surprising that various members of the Supreme Court have expressed significant concern regarding their place in a culture which places a high premium on due process of law. For example, in *Electrical Workers v. Foust*, 442 U.S. 42, 50 (1979), Justice Marshall, writing for himself and Justices Brennan, Stewart, White and Powell, pointed out that, "Because juries are accorded broad discretion as to the imposition and amount of punitive damages, . . . the impact of these windfall recoveries is unpredictable and potentially substantial." And Justice Marshall went on to state another danger of punitive damages – that "they may be employed to punish unpopular defendants." *Id.*, at 50-51 n.14.

In *Smith v. Wade*. Justice Rehnquist, writing for himself, the Chief Justice and Justice Powell, pointed out that punitive damages are generally rationalized on three grounds. First, they " 'are assessed for the avowed purpose of visiting a *punishment* upon the defendant.' " 461 U.S. 30, 58 (1983), *quoting* C. McCormick, *Law of Damages* 275 (1935) (emphasis added by Rehnquist, J.). but such a punitive fine if it should be imposed in a *civil* trial at all – "should go to the State, not to the plaintiff – who by hypothesis is fully compensated." *Id.*, at 59.

Second, Justice Rehnquist observed that punitive damages are justified as deterring "persons from violating the rights of others." *Id.*, at 58. Where a known rule of conduct is violated, as was the situation in *Smith v. Wade* itself, the "deterrence" rationale perhaps would provide some arguably rational basis for a State's authorizing the recovery of a reasonable amount of punitive

damages by a private person. But where, as here, no cause of action for bad faith failure to pay an insurance claim existed until almost fourteen years after execution of, and four years after performance under, the contract – much less a set of rules accompanying that cause of action to which appellant might have looked for guidance – it is plainly irrational to suggest that the retrospective application of new rules to historic conduct could have any deterrent effect.

Finally, Justice Rehnquist observed that punitive damages had been "justified as a 'bounty' that encourages private lawsuits seeking to assert legal rights." *Id.* It is, however, inconceivable that Alabama's interest in encouraging insureds to sue those with whom they have contracted bears any rational relationship to the $3,500,000 award in this case.

The defendant submits that the Due process Clause prohibits the imposition of *any* punitive damages in the context of the performance of contractual obligations in the absence of any fair warning that such damages might be imposed, in the absence of any articulated substantive rule of conduct which, by following, a party to a contract can avoid such liability, and in the absence of any interest of Alabama sufficient to outweigh the irrational impact on businesses such as the insurance business which, as argued above and as previously observed by the Supreme Court, depend greatly upon stability in their contractual relationships.

Since November 5, 1981, insurance companies operating in Alabama have been on some notice that their conduct in handling insurance claims could subject them

to punitive damages. Even today, however, Alabama's substantive rules of bad faith are unclear. Indeed, as the Supreme Court observed in this case, "[w]e need not blind ourselves to the fact that the law in the area of bad faith refusal-to-pay actions in Alabama [is] unsettled . . . ." 106 S. Ct., at 1586. Under these circumstances, the defendant submits that this punitive damage award must be reversed because it is inconsistent with the Alabama law in effect when the contract was entered, the Alabama law when the contract was performed, the Alabama law when the complaint was filed and the case tried, and the Alabama law as it stood when this Court handed down its prior decision of December 7, 1984. This Court may change the law of bad faith in Alabama, but no state interest of sufficient gravity to sustain this punitive damage award is present in a case in which, as here, this Court must apply new rules to past conduct.

Appendix G

IN THE SUPREME COURT OF ALABAMA

NO. 82-536
NO. 82-917

NATIONWIDE MUTUAL INSURANCE COMPANY

APPELLANT

V.

HENRY GERRARD CLAY

APPELLEE

APPEAL FROM THE CIRCUIT COURT FOR
THE THIRTEEN JUDICIAL CIRCUIT OF ALABAMA
(MOBILE COUNTY)

REPLY BRIEF OF APPELLANT NATIONWIDE MUTUAL INSURANCE COMPANY

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October 3, 1986

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INTRODUCTION

The Statements of the Case and the Facts by Nationwide were fair, accurate and nonargumentative. Appellee repeatedly emphasizes only Clay's testimony regarding key areas of disputed fact. That is contrary to the applicable procedural standard that all evidence relevant to the directed verdict be viewed in a light most favorable to Nationwide. Ignoring the areas of disputed fact also ignores the applicable substantive standard, for these disputes show that Nationwide had reasonably arguable grounds for declining to pay Clay's claim.

Appellee, for example, argues that Clay did cancel his Paul Revere coverage following his application to Nationwide. (Clay brief pp. 28, 29, 94, 96) Both Paul Revere employees, however, testified that Clay did not cancel the policy. (RT 453, 659) Another example of appellant's inaccuracies is the statement that Clay advised his friend McDowell, the Nationwide agent, upon applying for the Nationwide policy, that Clay did not have tax returns to verify his income representation. (Clay pp. 27, 99, 106, 107) McDowell testified he did not recall Clay ever mentioning tax returns. (RT 419-420)

In an effort to focus upon the issues in this appeal, Nationwide cannot address the inaccuracies and disputed facts throughout Appellee's brief. Doing so is unnecessary insomuch as the undisputed facts demonstrate that Nationwide had reasonable defenses of law and fact. (*See* Nationwide's principal brief pp. 32-49) Indeed, the very existence of the two sharply contrasting statements of fact underscores the presence of reasonably arguable issues involving Clay's claim for contract benefits.

Nationwide's focus on particular issues in this brief is not intended as a waiver of the other issues presented in its principal brief.

ARGUMENT

1. *THE UNITED STATES SUPREME COURT HAS REMANDED THIS CASE FOR FURTHER CONSIDERATION OF THE MERITS BY A CONSTITUTIONALLY COMPOSED COURT.*

This Court's order that "this case is due to be rebriefed" expresses this Court's correct understanding of what is required under the mandate by the Supreme Court of the United States. (*See* Nationwide's July 10, 1986, Reply to Clay's "Request for Briefing Schedule and Limitation of Issues on Remand.") Further consideration of the merits should be by "the Court" as a duly constituted collegial body.

2. *THERE IS UNDISPUTED EVIDENCE THAT NATIONWIDE HAD LEGALLY ARGUABLE REASONS FOR REFUSING TO PAY THE CLAIM AS SUBMITTED.*

A. *Nationwide had a reasonable basis on March 28, 1978, for questioning whether Clay made a misrepresentation in obtaining the policy.*

Clay concedes, at page 81, that whether an insurance company has a reasonably arguable basis of law or fact for refusing to pay a claim must be judged by reference to the circumstances before it at the time of the refusal. *See Insurance Company of North America v. Citizensbank of Thomasville*, 491 So.2d 880 (Ala. 1986). Subsequently occurring facts are immaterial to a determination of bad

faith.[1] The plaintiff has the burden of proving that if the contract claim had been tried on the date of the denial, the plaintiff would have been entitled to a directed verdict. (Clay p. 81)

In a lawsuit tried March 28, 1978, when Nationwide requested income verification, the amount of Clay's income most certainly would have been a disputed question precluding a directed verdict. The amount of Clay's income was still a fact question when this case was tried, even after records of Clay's gross law office receipts were obtained through discovery.

In a lawsuit tried March 28, 1978, another disputed question of fact would have been whether Clay misrepresented that his Paul Revere coverage would be "replaced" by the Nationwide coverage. Indeed, as of March 28, 1978, Clay's Paul Revere benefit had been *increased* from $400 to $2,200 monthly. Paul Revere indicated to Nationwide that Clay's policy was a "makeover," i.e., an upgraded renewal of the original policy. Moreover, it is undisputed that Nationwide would not have underwritten Clay's coverage of $900 had Clay not made the commitment to cancel the Paul Revere coverage. (RT 673-683) On March 28, 1978, Clay's total disability coverage was $3,100 monthly, whereas he had represented his income to Nationwide as $1,800 per month. (Def. Ex. 2)

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[1] Clay's repeated arguments are therefore immaterial regarding Nationwide's subsequent "demand" of further premiums and Nationwide's Answer alleging failure to mitigate by surgery.

Clay said he did call Paul Revere's local office to cancel the original coverage and later tried to call the Nationwide agent to cancel the Nationwide policy. That testimony, however, relates to events Nationwide was not told until after March 28, 1978. Furthermore, the key question is not what Clay intended, or even what actually happened, but how the events appeared to Nationwide. It appeared, and still does, that Clay did not keep his commitment (which was made a part of the contract itself) that the Paul Revere coverage would be replaced by the Nationwide coverage. At the very least, this issue of whether Clay complied with his commitment to "replace" his $400 Paul Revere coverage was a question of fact for the jury. The trial court erroneously preempted jury consideration by directing a verdict on the contract.

Clay makes no reply to possibly the most damning fact of all: his failure either to correct the information about his Paul Revere coverage or to rerurn the Nationwide policy for a full refund. In March, 1977, Clay received the Nationwide policy containing his commitment to cancel the Paul Revere coverage. (RT 268) Clay knew then that he had already raised his Paul Revere coverage from $400 to $2,200 monthly. (RT 268) The front page of the Nationwide policy contained a warning in bold print regarding any incorrect or omitted information in the application. The policy also instructed that if Clay wanted to cancel the policy, he could do so by mailing it back to the company within 10 days for a full refund of his premiums. Clay's subsequent failure to correct the misrepresentation about his Paul Revere coverage should have resulted in a judgment as a matter of law for

Nationwide based on the holding of *National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357 (Ala. 1983). It still should.

Clay argues in the alternative that Nationwide is estopped from claiming misrepresentation in the application because it never returned the premiums Clay had paid. That contention, never asserted in the trial record, overlooks the undisputed fact that the $5,200 in benefits paid by Nationwide exceeded the amount of premiums paid by Clay. (RT 247) If anything, Nationwide was entitled to a setoff of the benefits paid in excess of the premiums.[2]

B. *The amount of the contract judgment itself demonstrates the reasonableness of Nationwide's defense.*

Clay fails to join issue on this point. He attempts to escape the significance of the judgment amount by saying that (a) Nationwide did not preserve the trial court's calculations in the record, and (b) Nationwide's argument regarding the Relation of Earnings to Insurance clause is "inconsistent" with its defense of misrepresentation in the application. As to the first point, the arithmetic of the trial court's computations is not an issue. The face of the record shows the judgment amount on the contract claim was less than what the plaintiff alleged he was entitled to receive. *Cf. First State Ins. Co. v. Wallace*, No. 83-7206 (11th

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[2] Clay's alternative argument that Nationwide's contract defenses were waived is contrary to authority that waiver is a fact question for the jury. *See, e.g., Piedmont Fire Ins. Co. v. Tierce*, 245 Ala. 415, 17 So.2d 133, 137 (1944). Furthermore, contract defenses relating to coverage, such as the amount of coverage owed, cannot be waived. *Home Indemnity Co. v. Reed Equip. Co.*, 381 So.2d 45, 51 (Ala. 1980).

Cir. 1984) (Alabama law).[3] As a matter of law, Nationwide had a partially successful defense to the contract claim and, therefore, should have received a directed verdict on the bad faith claim. As to the "inconsistency," there is nothing inconsistent in Nationwide's position that, even if there were no misrepresentation, Clay's income and other insurance did not entitle him to full benefits by operation of the Relation of Earnings to Insurance clause. Nationwide's contract obligation arose only if the policy were not void by reason of the misrepresentation. If the policy were not void, the question then became how much was due under the policy, which was a question of fact.[4]

C. *Nationwide's legal arguments regarding ambiguity, partial payments, and failure to provide requested information involve matters fully developed in the record.*

The trial court's ruling that Nationwide's application was ambiguous on the meaning of "income" was a response to Nationwide's affirmative defense of misrepresentation in the application. Assuming there was an ambiguity in the term "income," the resolution of that

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[3] A copy of that decision is reproduced in Nationwide's principal brief at Appendix B-1.

[4] Clay's income tax returns were relevant to both questions: (a) whether there was a misrepresentation in the first instance, and (b) the amount owed under the policy in the second instance. Income tax returns are generally the best evidence of one's income. Clay had the option of producing any other information that would verify his income, but refused to do so.

ambiguity was an issue Nationwide was reasonably entitled to debate without being subjected to punitive damages. Clay replies that Nationwide was estopped from asserting the misrepresentation defense because it never returned Clay's premiums. That contention is answered in Part 2(A) above. Clay argues in the alternative that the ambiguity question is a "red herring" because Clay's gross income after expenses averaged more than $1,800 monthly in the two years before the application. Nationwide had used a one year average in determining Clay's income. What was a reasonable time period for computing Clay's average monthly income at the time he represented it to be $1,800 was a fact question that should have been left to the jury. It was certainly a question for the jury whether "income" meant net income or gross receipts.

Clay asks the Court to disregard Nationwide's arguments pertaining to partial payments and Clay's refusal to furnish income verification on the basis that they are affirmative legal defenses not pled by Nationwide. That evidence does not merely establish an avoidance of a contract obligation. It also negatives the tort claim of bad faith. It was therefore properly offered concerning an issue tendered by the complaint, quite apart from any affirmative defense. These relevant facts, fully developed in the record, constitute undisputed evidence that Nationwide did not commit the tort of bad faith. (*See* Nationwide's principal brief pp. 42-49) The $1.25 million punitive damages verdict thus was contrary to the evidence as a matter of law.

For the same reason, Clay is incorrect in stating that Nationwide is raising, for the first time, a "lack of cooperation defense" under the policy. (Clay 116) Nationwide's

position is based on the mutual duty of good faith and fair dealing that arises out of the relationship between insured and insurer.[5] An insured who invokes the insurer's part of that duty must himself have fulfilled his counterpart duty. Clay's refusal to substantiate his income breached that counterpart duty. As further evidence of Clay's comparative bad faith, he knowingly misled the Nationwide claims examiner about the existence of other disability insurance. (RT 122) On that point, Clay fails to distinguish *Linthicum v. Nationwide Mut. Ins. Co.*, No. 86-0061 (Ariz. 1986),[6] which involved a virtually identical issue. The essential point is that an insured should not be allowed to intentionally withhold material information and later allege bad faith for the company's refusal to pay the claim.

3. *THIS COURT HAS THE JURISDICTION AND POWER TO ADDRESS THE CONSTITUTIONAL ISSUES RAISED BY NATIONWIDE.*

Clay incorrectly contends that this Court has no jurisdiction to review the Constitutional issues raised. Extensive authority affirms that this Court has both the jurisdiction and power to address legal issues not raised in the trial court. *See Warrior Drilling and Engineering Co. v. King*, 446 So.2d 31, 34 (Ala. 1984); *Green v. Taylor*, 437 So.2d 1259, 1260 (Ala. 1983); *Green v. Standard Fire Ins. Co.*, 398 So.2d 671, 676 (Ala. 1981); *Whitman v. Knapp*, 285

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[5] The cases cited by Clay at page 117 for the proposition that "failure to cooperate" is an affirmative defense each involve contract defenses under a cooperation clause, which is not asserted here.

[6] A copy of that decision is reproduced in Nationwide's principal brief at Appendix C-1.

Ala. 57, 63, 228 So.2d 814 (1969); *Head v. Triangle Const. Co.*, 274 Ala. 519, 150 So.2d 389, 392 (1963). *See also, Denis v. Liberty Mutual Ins. Co.*, 791 F.2d 846 (11th Cir. 1986) (federal procedure); *Garrison v. Dothard*, 366 So.2d 1129, 1131 (Ala. Civ. App. 1979); *Crews v. Houston Co. Dep't of Pensions and Security*, 358 So.2d 451, 455 (Ala. Civ. App. 1978); *Jaffe Corp. v. Board of Adjustment*, 361 So.2d 556, 560 (Ala. Civ. App. 1977). These cases establish that, where the facts make a legal contention relevant, the failure to make the contention in the trial court raises only prudential concerns that do not limit the Court's jurisdiction and power to decide those questions. No rule under the Alabama Rules of Civil or Appellate procedure prohibits the raising of legal issues, especially federal Constitutional issues, for the first time on appeal.

The purpose of the general rule against raising new issues on appeal is to assure "proper development of the record in the court below" and afford the trial court "an opportunity to correct its own errors." *Green v. Taylor*, 437 So.2d 1259, 1260 (Ala. 1983). Those concerns do not exist here, for the same undisputed facts are the basis of all the questions raised by Nationwide. Since the Constitutional arguments are purely issues of law, not dependent on any further development of facts, no purpose would be served by rigid application of the "not raised below" rule. Furthermore, it is inappropriate to expect a trial court to constrain the development of common law torts in Alabama, particularly the imposition of substantial punitive damages, by application of the federal Constitutional arguments advanced here. The trial court refused even to exercise its discretionary power under Alabama law to reduce the punitive award. There is "little point in

requiring a litigant to request a state court to overrule or modify one of this Court's precedents." *Illinois v. Gates*, 462 U.S. 213, 251 (1983) (White, J., concurring in the judgment). In short, none of the prudential concerns is preclusive of the Constitutional issues raised here.

If this Court has the power and authority under Alabama law to decide the Constitutional issues raised by Nationwide, then under the opinion by the Supreme Court of the United States in *Aetna Life Ins. Co. v. Lavoie*, 106 S. Ct. 1580, 89 L. Ed.2d 823 (1986), it has an obligation to do so.[7] Should there not be a reversal on the state law issues, there is not a more appropriate setting for resolution of these Constitutional issues than this case and/or *Aetna Life Ins. Co. v. Lavoie, supra*. There has been unusually comprehensive briefing, discussion and interest in both cases. The Constitutional questions involving punitive damages are a matter of enormous public concern, a circumstance further justifying consideration by this Court despite the question not having been raised in the trial court. *See Jaffe Corp. v. Board of Adjustment*, 361 So.2d at 556. *See also, Warrior Drilling v. King*, 446 So.2d at 34. Nationwide squarely challenged the $1.25 million punitive damages judgment below on state law grounds, and there is now no reasonable jurisdictional or prudential basis for refusing to consider the federal Constitutional grounds for that challenge.

---

[7] The Supreme Court observed that these Constitutional arguments "raise important issues which, in an appropriate setting, must be resolved." 89 L. Ed.2d at 837.

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Appendix H

IN THE SUPREME COURT OF ALABAMA

NO. 82-536
NO. 82-917

NATIONWIDE MUTUAL INSURANCE COMPANY

APPELLANT

V.

HENRY GERRARD CLAY

APPELLEE

APPEAL FROM THE CIRCUIT COURT FOR
THE THIRTEENTH JUDICIAL CIRCUIT OF ALABAMA
(MOBILE COUNTY)

APPLICATION FOR REHEARING OF
NATIONWIDE MUTUAL INSURANCE COMPANY
AND SUPPORTING BRIEF

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APPLICATION FOR REHEARING

Appellant Nationwide Mutual Insurance Company (hereinafter "Nationwide") submits this Application for Rehearing challenging the correctness of the Court's opinion to point out the errors which infect the opinion and decision. In conformance with Rule 40 this application is combined with the supporting brief contained below.

BRIEF IN SUPPORT OF APPLICATION FOR REHEARING

I. *The Court has arbitrarily refused to order a remittitur.*

In affirming the $1.25 million punitive damages award, the Court has arbitrarily refused to exercise its remittitur authority, as demonstrated by the Court's decision herein compared with its prior practice in *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981), and *Aetna Life Ins. Co. v. Lavoie*, 505 So.2d 1050 (Ala. 1987). Furthermore, the Court has arbitrarily failed to apply its own procedure requiring remand to the trial court for opinion on the remittitur question, as set forth in *Hammond v. City of Gadsden*, 493 So.2d 1274 (Ala. 1986), and its progeny.

The absence of any consistent standards for remittitur compound the lack of any uniform bounds for submitting the question of punitive damages to the jury, thereby infringing Nationwide's Due Process and Equal Protection rights under the Alabama and United States Constitutions. The result is arbitrarily disparate punitive damage jury awards in tort of bad faith cases, as demonstrated by comparison of the award in this case with jury

awards in cases involving similar alleged conduct. *See, e.g., Aetna Life Ins. Co. v. Lavoie, supra* ($3.5 million); *Continental Ins. Co. v. Kountz,* 461 So.2d 802 (Ala. 1984), ($25,000); *Blue Cross and Blue Shield v. Granger,* 461 So.2d 1320 (Ala. 1984) ($500,000); *Independent Life & Acc. Ins. Co. v. Parker,* 449 So.2d 233 (Ala. 1984) ($16,000); *Cincinnati Ins. Co. v. Little,* 443 So.2d 891 (Ala. 1983) ($80,000); *National Sav. Life Ins. Co. v. Dutton,* 419 So.2d 1357 (Ala. 1982) ($14,000); *Gulf Atlantic Life Ins. Co. v. Barnes, supra,* ($1.1 million).

Thus independent state law error was committed by the Court in arbitrarily refusing to exercise its remittitur authority in a consistent manner (without any guiding standards), and in failing to apply the Court's own remand procedure articulated in *Hammond* and its progeny.

II. *The Court erred in its application of State and Federal Constitutional Law.*

A. The Court erroneously held it is without jurisdiction to address constitutional issues first raised on appeal.

Contrary to the Court's assertion [M.S. 9], no statute or rule prohibits this Court from resolving a constitutional issue first raised on appeal, especially where that issue is purely a question of law not dependent upon any further development of facts in the trial court. There is extensive authority that this Court has both the jurisdiction and power to address legal issues not raised in the trial court. (*See* Nationwide's Reply Brief of October 3, 1986, pp. 12-14) Furthermore, Nationwide could not be expected to foresee this Court's failure to adhere to the

precedent established in *Gulf Atlantic Life Ins. Co. v. Barnes, supra,* wherein the Court, in its only affirmance of a tort of bad faith verdict before the trial of this case, remitted the judgment from $1.1 million to $100,000 as "excessive and obviously the result of passion and prejudice on the part of the jury". 405 So.2d at 926.

B. Nationwide is due relief from the mandatory affirmance penalty.

In its Appellant's Brief of August 15, 1986, Nationwide challenged the constitutionality of Ala. Code § 12-22-72, which imposed a mandatory affirmance penalty of 10 percent upon defendant-appellants but no similar penalty upon plaintiff-appellants. On June 11, 1987, that penalty was abolished by 1987 Ala. Acts No. 188, which expressly stated that it was effective immediately. (*See* Appendix A, *infra*) We assume there would be no penalty assessed against Nationwide since the June 26 opinion herein was issued after the new law became effective. If there is such an assessment, Nationwide incorporates its earlier challenge under the Fourteenth Amendment to the United States Constitution. *See, Burlington Northern R.R. Co. v. Woods,* 480 U.S. ___, 94 L.Ed.2d 1, 107 S.Ct. 967 (1987); *Lindsey v. Normet,* 405 U.S. 56 (1972).

III. *The Court erred in its application of State Common Law.*

A. The Court erred at law in holding the existence, *vel non,* of a contract ambiguity is not a debatable issue.

In affirming that "average earned monthly income" is ambiguous, and also holding that Nationwide had no

arguable defense, the Court has essentially rewritten Alabama law on contract ambiguities. Formerly, the mere fact that adverse parties advocated different interpretations did not force a legal conclusion that such language was ambiguous. *Antram v. Stuyvesant Life Ins. Co.*, 291 Ala. 716, 720, 287 So.2d 837 (1973). In numerous cases this Court has ruled *against* policyholders on the existence of an ambiguity. *See, e.g., Smith v. Kennesaw Life & Acc. Ins. Co.*, 284 Ala. 12, 221 So.2d 372 (1969); *Maryland Cas. Co. v. Allstate Ins. Co.*, 281 Ala. 671, 207 So.2d 657 (1968); *Canal Ins. Co. v. Stidham*, 281 Ala. 493, 205 So.2d 516 (1967). Contrary to the holding in this case, Nationwide had a legal right to litigate its interpretation of "earned income" (under which Clay was guilty of a misrepresentation) without suffering punitive damages. At a minimum, that constituted a "legitimate argument of law or fact" sufficient to defeat a bad faith claim.

B. The Court erred at law in holding there was "no rational basis" for Nationwide's argument that twelve-month average of Clay's income be used to determine if he misrepresented his "average earned monthly income".

The amount of Clay's "average earned monthly income" when he signed the application was a jury question based on the unique facts of Clay's earnings history as shown at trial. Changes in circumstances do affect one's income, and Clay's income showed a steady pattern of decline. One whose income has diminished or ceased certainly would not be correct in representing his then average income at its two year average, as the Court suggests. Because of Clay's steadily declining income, Nationwide contended for a one-year average, but the

jury as easily could have used a few months. It was a jury question.

C. The Court erroneously found the *amount* of benefits owed by Nationwide "was not an issue" when this dispute arose.

In rejecting Nationwide's argument that a dispute existed as to the *amount* of benefits owed, the Court states erroneously that "was not an issue" when the company made its initial denial based on preexisting condition. [M.S. 5] As the record and briefs disclose, that denial was later cured and Nationwide began making payments under the "waiting period" rider totaling $5,200.00. The present (totally separate) dispute later arose when questions developed concerning Clay's income and other insurance, which did affect the amount he would be due in monthly contract benefits (vis-a-vis rider payments).

D. The Court erred at law in deeming "irrelevant" Clay's representation that the Nationwide policy would "replace" the Paul Revere policy.

Whereas the Court states Clay's representation is "irrelevant" because he *intended* to cancel the Paul Revere coverage, Ala. Code § 27-14-7 voids coverage for *any* incorrect information regardless of the applicant's intent. Moreover, the Court erroneously overlooks the fact that by the time Clay received the Nationwide policy he had already increased his Paul Revere coverage, but failed to correct the application as instructed in the policy. *Cf. National Sav. Life Ins. Co. v. Dutton, supra.*

E. The Court erred in at least four other recitations of fact.

The Court erroneously found the "waiver of premium" term "should have taken effect" [M.S. 4] contrary to the policy, which did not provide a waiver of premium during the six-month waiting period while Clay was receiving rider payments. The Court erroneously stated "Clay was never informed . . . that the claim was subject to proration" [M.S. 6] contrary to the insurance policy itself, which so informed Clay under the Relation of Earnings to Insurance provision. *Cf. Woodlawn Fraternal Lodge v. Commercial Union Ins. Co.*, ___ So.2d ___, 21 A.B.R. 2764 (Apr. 24, 1987). The Court erroneously stated that "Clay never demanded any specific amount" on his contract claim [M.S. 6] contrary to the document contained in Appendix A to Nationwide's brief of August 15, 1986. Finally, the Court's statement that Nationwide "waived" any contract defense by continuing to accept premiums contradicts prior case principles, *Home Indem. Co. v. Reed Equip. Co.*, 382 So.2d 45 (Ala. 1980), *Piedmont Fire Ins. Co. v. Tierce*, 245 Ala. 415, 17 So.2d 133 (1944), and incorrectly presumes Nationwide did anything more than *ask for income substantiation* (it did not deny coverage) before suit was filed.

IV. *The Court erred in failing to grant Nationwide's motion for disqualification of all members of the Court originally hearing and deciding this case.*

The voting alignment of the June 26, 1987, opinion brings into even sharper focus Nationwide's arguments on disqualification of the Court as a collegial body, as first raised in Nationwide's motion of February 22, 1985. As recognized in the concurring opinion of Justice Brennan, the participation of Justice Embry "*necessarily*

import[ed] a bias into the deliberative process". *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. ___, 89 L. Ed.2d 823, 839, 106 S.Ct. 1580 (1986) (Brennan, J., concurring). (emphasis in original) Without suggesting any impropriety, Nationwide submits that perceptions shaped in the original deliberative process, wherein the Court first decided which issues must be addressed and how they would be addressed, cannot be cured merely by redeliberation of the remaining justices. Consequently, once the bias is injected into the deliberative process, it can never satisfactorily be removed.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that I have this 10th day of July, 1987, served a copy of the foregoing Application for Rehearing and Supporting Brief upon Counsel for Appellee, FRED W. KILLION JR., Esquire, 3662 Dauphin Street, Mobile, Alabama, by hand delivery, and by first class mail upon Counsel for Amicus Curiae, EDGAR M. ELLIOTT III,

Esquire, Rives & Peterson, 1700 Financial Center, Birmingham, Alabama 35203.

/s/ Bert S. Nettles
BERT S. NETTLES

Appendix I

IN THE SUPREME COURT OF ALABAMA

NATIONWIDE MUTUAL INSURANCE COMPANY, Appellant, V. HENRY GERRARD CLAY, Appellee.	CASE NUMBERS: 82-536 and 82-917

REPLY MEMORANDUM OF
NATIONWIDE MUTUAL INSURANCE COMPANY

This memorandum is in response to Clay's Request for Briefing Schedule and Limitation of Issues on Remand in which Clay contends it remains unresolved whether the original opinion should be set aside due to Justice Embry's participation. That position was rejected by the May 5, 1986, order of the Supreme Court of the United States and subsequent denial of Clay's application for rehearing. Clay's suggestion that the prior judgment in this case should not be set aside is an effort to circumvent the express orders of that Court.

On June 13, 1985, Nationwide Mutual Insurance Company ("Nationwide") petitioned for certiorari in the Supreme Court of the United States seeking review of this Court's earlier judgment and order denying Nationwide's Motion for Withdrawal of Opinion and Suggestion of Disqualification. In that motion and petition for certiorari, Nationwide asserted that the judgment should be set aside due to Justice Embry's participation and that all the justices then sitting should be recused from further consideration of this case by reason of Justice Embry's involvement in the Court's deliberations. The petition for certiorari was granted.

As in *Aetna Life Ins. Co. v. Lavoie*[1], the Supreme Court of the United States ordered that the prior judgment in this case is "vacated," meaning the original opinion is of no precedential value. *County of Los Angeles v. Davis*, 440 U.S. 625, 634 n.6 (1979). Such was a necessary consequence of the Supreme Court's opinion in *Aetna v. Lavoie*, wherein it was held that Justice Embry's participation violated due process. The Supreme Court of Alabama being an appellate court which deliberates and decides cases as a collegial body, the prior decision of that court must necessarily be vacated.[2]

The question now before this Court is whether the case may constitutionally be considered by the remaining

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[1] The order in *Aetna Life Ins. Co. v. Lavoie* stated: "The judgment of the Supreme Court of Alabama is vacated, and the case is remanded for further proceedings not inconsistent with this opinion." 475 U.S. ___, 89 L.Ed.2d 823, 837 (1986). In the present case, the Court's order stated: "The judgment is vacated and the case is remanded to the Supreme Court of Alabama for further consideration in light of *Aetna Life Ins. Co. v. Lavoie.*"

[2] Justice Brennan specially concurred in *Aetna Life Ins. Co. v. Lavoie* "to set forth my understanding of certain statements in the Court's opinion." 89 L.Ed.2d at 838. Contrary to Clay's position, Justice Brennan stated: "I understand that the Court's opinion is not to be read to suggest that the outcome might be different had Justice Embry not provided the necessary fifth vote in the court below." *Id.* His participation "*necessarily* imports a bias into the deliberative process" and "was sufficient in itself to impugn the decision." *Id.* (emphasis in original) The due process question is not one of arithmetic. However, neither should it be one of guess and surmise as to Justice Embry's role in shaping the tort of bad faith and deciding this case. The original opinion, being that of "the Court," must be set aside without further inquiry as to Justice Embry's role.

seven justices on the Supreme Court of Alabama who participated in this Court's prior decision. In that respect, the disqualification issue raised before the Supreme Court of the United States by Nationwide differs from that raised by Aetna in its appeal. Whereas Aetna challenged the participation of the other eight justices due to their membership in the putative class Justice Embry sought to represent, Nationwide argued that the other justices necessarily were influenced to some degree by Justice Embry's participation in the Court's deliberations. While Aetna's argument was rejected by the Supreme Court, Nationwide's February 22, 1985, request for appointment of a special court empaneled under Ala. Code § 12-2-14 (1975) has not been resolved.[3]

If this Court has any doubt as to the setting aside of the prior decision, then Nationwide agrees that issue is of such importance as to warrant special briefing. Likewise, if this Court is undecided on the question involving the

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[3] Under this statute, when by reason of disqualification the members of the Supreme Court cannot sit, the Governor of Alabama shall appoint seven members of the state bar to constitute a special supreme court to hear and decide such case. *Cf. Ex parte Alabama Power Company*, 280 Ala. 586, 196 So.2d 702 (1967). This substitution procedure was simplified in 1973 by a new judicial article of the Alabama Constitution. Alabama Constitutional Amendment No. 328, section 6.10, provides that the Chief Justice of the Supreme Court of Alabama may assign trial or appellate judges (retired or active) "for temporary service in any court." That procedure was followed in *Duncan v. Johnson*, 338 So.2d 1243 (Ala. 1976), when the Chief Justice and all the associate justices recused themselves "because a justice had represented one of the parties to the litigation." *Aetna v. Lavoie*, 470 So.2d 1060, 1092 n.1 (Ala. 1985) (Maddox, concurring specially on the disqualification issue).

remaining seven justices who participated in the prior decision, that question likewise warrants special briefing. Nationwide has heretofore requested a Rule 33 Prehearing Conference to assist the Court in simplyfying these issues and in planning the orderly disposition of this case.

CONCLUSION

The original judgment has been vacated, necessitating further consideration of the merits. The question now before this Court is how best to handle the appeal in a manner that will satisfy the constitutional guarantees of due process. If the Court has doubt as to how it should proceed, then Nationwide agrees the subject is of such importance as to warrant special briefing and/or a Rule 33 prehearing conference.

Respectfully submitted,

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Appendix J

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May 23, 1988

FEDERAL EXPRESS

Honorable Robert G. Esdale, Clerk
Supreme Court of Alabama
445 Dexter Avenue
Montgomery, Alabama 36101

RE: Nationwide Mutual Insurance Company vs. Henry Gerrard Clay
Case Numbers: 82-536 and 82-917
NBJ&C File Number: 111-3295

Dear Mr. Esdale:

Reference is made to my telephone conversation last Friday, May 20, with Staff Attorney Cary Gaston of your office. It is unclear to Nationwide from the record whether the judgment affirmed June 26, 1987, will be subject to the ten percent affirmance penalty that was abolished effective June 11, 1987. In light of the opinion by Justice Maddox, concurring specially, in the Court's

April 29, 1988, Order denying Nationwide's Application for Rehearing, it appears the Court does intend to impose an affirmance penalty on this judgment. The majority opinion, however, is silent on the issue.

Should there be any remaining question, Nationwide respectfully submits the meaning and effect of the U.S. Supreme Court's order "vacating" the prior judgment of this court precludes the imposition of the now-abolished affirmance penalty. *See Tims v. Holland Furnace Co.*, 152 Ohio St. 469, 90 N.E.2d 376, 380 (1950) ("The generally accepted rule is that where a court, in the proper discharge of its judicial functions, vacates an order or judgment previously entered, the legal status is the same as if the order or judgment had never existed"). *Accord, County of Los Angeles v. Davis*, 440 U.S. 625, 634 N.6, 99 S.Ct. 1379, 59 L.Ed.2d 642 (1979); *Riha v. International T. & T. Corp.*, 533 F.2d 1053, 1054-55 (8th Cir. 1976); *Mitchell v. Joseph*, 117 F.2d 253, 255 (7th Cir. 1941).

We would welcome the opportunity to further brief this issue if the Court deems it helpful.

Sincerely,

NETTLES, BARKER, JANECKY
& COPELAND, P.C.

/s/ Bert S. Nettles
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Appendix K

IN THE SUPREME COURT OF ALABAMA

NATIONWIDE MUTUAL INSURANCE COMPANY, Appellant,	)	CASE NUMBER 82-536 82-917
V.	)	
HENRY GERRARD CLAY, Appellee.	)	

MOTION FOR WITHDRAWAL OF OPINIONS AND SUGGESTION OF DISQUALIFICATION

(Filed February 22, 1985)

Comes now appellant Nationwide Mutual Insurance Company ("Nationwide") and moves that the opinion in this cause announced February 8, 1985 (along with recent opinions in two other appeals), be withdrawn, that all of the justices of this Court recuse themselves, and for other relief. As grounds therefor, Nationwide says as follows:

1. On January 19, 1984, an action was filed in the name of T. Eric Embry in the District Court of Jefferson County, Alabama, seeking, among other things, punitive damages for the tort of bad faith against Maryland Casualty Company wherein plaintiff T. Eric Embry alleged, among other things, " . . . that defendant in bad faith, willfully, intentionally, and/or maliciously failed to pay a valid claim under the aforementioned insurance contract without lawful excuse." Certified copies of the complaint and the case action summary in that action are attached hereto as Exhibit A and incorporated herein by reference. That action was dismissed with prejudice at defendant's cost on or about April 6, 1984.

2. On January 31, 1984, an action was filed in the name of T. Eric Embry in the Circuit Court of Jefferson County, Alabama, seeking, among other things, punitive damages for the tort of bad faith against Blue Cross/Blue Shield of Alabama. Plaintiff T. Eric Embry alleged in that action, among other things, that Blue Cross and Blue " . . . has committed the tort of bad faith . . . in failing and refusing to pay to plaintiff and other members of the class the benefits to which they are entitled pursuant to the insurance policy or contract. . . ." The intensity of plaintiff T. Eric Embry's feeling is evidenced by his allegation seeking compensatory damage for "breach of contract, inconvenience, emotional and mental distress, disappointment, pain and suffering." Certified copies of the complaint and the case action summary in that action are attached hereto as Exhibit B and incorporated herein by reference. That action is still pending.

(NOTE: As is noted in Exhibit B, plaintiff T. Eric Embry has brought this action " . . . on behalf of himself and all other persons who are members of the Alabama State Employees Health Insurance Plan carrying medical and hospitalization insurance through Blue Cross/Blue Shield of Alabama, Group Policy Number 1300." No resolution has yet been made by the trial court on plaintiff T. Eric Embry's request for "an order certifying this class as a class action pursuant to Rule 23, Alabama Rules of Civil Procedure.")

3. On the morning of March 28, 1984, Associate Justice T. Eric Embry sat as one of the five justices hearing oral argument on this appeal involving, among other things, a $1,250,000.00 tort of bad faith punitive damage judgment against Nationwide. During that oral argument which primarily centered on the question of "bad faith"

damages, Mr. Justice Embry never mentioned to counsel the fact that he was a plaintiff in two bad faith damage suits against insurance companies then pending in the District and Circuit Courts of Jefferson County.

4. Presumably Associate Justice T. Eric Embry thereafter actively participated in conference with all of his fellow justices of this Court in the decision-making process of this case. Mr. Justice Embry was one of the majority in the 6 to 3 decision announced February 8, 1985, affirming the $1,250,000.00 bad faith punitive damage decision due to the " . . . uncooperative, intransigent behavior of the Nationwide agents," even though there was no finding of oppressiveness or maliciousness. He was joined in that majority decision by the other three members of his judicial panel, with a majority decision having been written by one of the justices of that panel.

5. Subsequent to the initial recognition of the tort of bad faith in the cases of *Chavers v. National Security Fire and Casualty Company,* 405 So.2d 1 (Ala. 1981), and *Gulf Atlantic Life Ins. Co. v. Barnes,* 405 So.2d 916 (Ala. 1981), both announced on October 2, 1981, this Court had issued a series of opinions sharply limiting application of the tort of bad faith. In an unbroken line of 11 straight cases decided in the following three years by this Court on the subject of bad faith, in each instance the Court ruled in favor of the insurance company appellant or appellee in holding the tort of bad faith inapplicable to the facts of each such case . . . repeatedly emphasizing "the heavy burden that a plaintiff must bear in a bad faith case." A chart diagraming those cases and the recent bad faith holdings is attached hereto as Exhibit C and incorporated herein by reference.

6. However, in the 5 to 4 per curiam decision of December 7, 1984, in *Aetna Fire and Casualty Company v. Lavoie,* 19 ABR 271, this Court for the first time since October, 1981, found bad faith existent and affirmed a punitive damage award against an insurance company in the amount of $3.5 million. The other three members of Mr. Justice Embry's panel joined him in the majority opinion.

7. On December 21, 1984, in the case of *Continental Assurance Company v. Kountz,* 19 ABR 462, Associate Justice T. Eric Embry and the other three members of his judicial panel again joined with the majority of the Court in affirming another bad faith punitive damage verdict. That same day (in a decision in which Mr. Justice Embry and other three members of his panel did not participate) this Court ruled in favor of an insurance company in *Tyson v. Safeco Insurance Companies,* 19 ABR 523, holding that bad faith did not apply. Also on December 21, 1984, this Court reversed a $500,000.00 bad faith award in the case of *Blue Cross/Blue Shield v. Granger,* 19 ABR 444, a case in which Mr. Justice Embry and one other member of his panel had recused themselves.

8. Associate Justice T. Embry and the other three members of his judicial panel were the only Justices of this Court who ruled with the plaintiff in all three of the recent affirmances of bad faith awards. That hardline unanimity is a new phenomenon. Mr. Justice Embry himself dissented from the original recognition of bad faith in *Chavers v. National Security Fire and Casualty Company, supra.* Another member of Mr. Justice Embry's judicial panel dissented in both *Chavers* and the companion holding in *Gulf Atlantic Life Ins. Co. v. Barnes, supra.*

9. Prior to the December 7, 1984, affirmance in *Aetna Fire and Casualty Company v. Lavoie, supra,* the only bad faith punitive damage award affirmed by this Court was in the October 2, 1981, case of *Gulf Atlantic Life Ins. Co. v. Barnes, supra.* However, in *Barnes,* even after concluding that "the jury could reasonably have concluded that the insurer tried to cover its 'mistake' without any existing debatable," this Court held (at p. 926) as follows:

> "The judgment rendered against the insurance company in the amount of $1,100,000.00, however, is excessive and obviously the result of passion and prejudice on the part of the jury."

This Court in *Barnes, supra,* then ordered a remittitur whereby the punitive damage award was reduced from $1,100,000.00 to only $100,000.00. However, in *Aetna Fire and Casualty Company v. Lavoie, supra,* decided on December 7, 1984, the majority of this Court in a per curiam opinion affirmed a $3.5 million award against insurance company without attempting in any way to distinguish the remittitur holding in *Barnes, supra.* Likewise, in the opinion announced on February 8, 1985, in the instant case, a majority of the Court affirmed the $1,250,000.00 punitive damage bad faith award against Nationwide. Again there was not even an attempt to distinguish this case from the prior holding in *Barnes, supra,* reducing that damage award to less than 10 percent of the original verdict.

10. On February 14, 1985, Nationwide and its counsel first learned of Associate Justice T. Eric Embry's two bad faith suits against insurance companies as mentioned in paragraphs 1 and 2 of this motion. An affidavit to that

effect is attached hereto as Exhibit D to this motion and incorporated herein by reference.

11. Alabama Code § 12-1-12 (1975) provides in pertinent part as follows:

> "No judge of *any* court shall sit in any case or proceeding in which he is interested . . . without the consent of the parties entered of record or put in writing if the court is not of record."

12. The Preamble to the Canons of Judicial Ethics adopted by the Alabama Supreme Court on December 15, 1975, and which became effective on February 1, 1976, is as follows:

> "The first Code of Legal Ethics in the United States was formulated and adopted by the Alabama State Bar Association in 1887. This first Code was adopted with only minor changes by Georgia, Virginia, Michigan, Colorado, North Carolina, Wisconsin, West Virginia, Maryland, Kentucky and Missouri between 1887 and 1906, and finally by the American Bar Association in 1908. Recognizing Alabama's leadership in the field of professional ethics and mindful that the character and conduct of a judge should never be objects of indifference and that declared ethical standards tend to become habits of life, the supreme court of Alabama deems it desirable to formulate and establish those principles which govern the conduct of members of the judiciary. The supreme court of Alabama accordingly adopts the following canons, as a Code for judges and a declaration of that which the people of the state of Alabama have a right to expect of them."

Canon 1 of those canons is entitled, "A judge should uphold the integrity and independence of the judiciary," and provides:

> "An independent and honorable judiciary is indispensable to justice in our society. A judge should participate in establishing, maintaining, and enforcing, and should himself observe, high standards of conduct so that the integrity and independence of the judiciary may be preserved. The provisions of this Code should be construed and applied to further that objective."

Canon 2 of those canons is entitled, "A judge should avoid impropriety and the appearance of impropriety in all his activities," and provides in section A thereof as follows:

> "A. A judge should respect and comply with the law and should conduct himself at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary."

Canon 3 of those canons is entitled, "A judge should perform the duties of his office impartially and diligently," and provides in sections C(1)(d)(ii) thereof as follows:

> "C. Disqualification:
> (1)A judge should disqualify himself in a proceeding in which his disqualification is required by law or his impartiality might reasonably be questioned, including but not limited to instances where:
>
> . . .
>
> (d) He or his spouse, or a person within the fourth degree of relationship to either of them, or the spouse of such a person:
>
> . . .
>
> (ii) Is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding."

13. Having bad faith action of his own against one insurance company pending at oral argument, throughout submission and to the present time, and having another bad faith action against a different insurance company pending at the time of oral argument in this case, Associate Justice T. Eric Embry had an interest in revitalizing and then expanding the application of the tort of bad faith, as well as in affirming (without remittitur) excessively large damage awards in "bad faith" cases.

14. Because of Associate Justice Embry's interest in the outcome of this case, under Alabama Code § 12-1-12 (1975) and under the aforesaid Canons of Judicial Ethics of this state, Mr. Justice Embry was and is disqualified from participating in this appeal.

15. Due to the patently improper participation of Associate Justice T. Eric Embry in this appeal and in the cases of *Aetna Fire and Casualty Company v. Lavoie, supra,* and *Continental Assurance Company v. Kountz, supra,* this entire appellate proceeding and the appellate proceedings and opinions in *Lavoie* and *Kountz* have been illegal and prejudicially unfair to Nationwide.

16. The other members of Associate Justice T. Eric Embry's judicial panel, the other two justices voting with the majority in this case, and even the dissenting justices have all been affected and influenced at least to some degree by the patently improper participation of Mr. Justice Embry in this appeal. Appellate judges do not reach their decisions in a vacuum. They are influenced by each other as well as by their knowledge of the law and the record. Once one of the justices with a personal

interest has entered into a discussion on the merits of a case in general conference, the opinions of that brother judge will have affected everyone who was a party to that discussion or discussions. It is not possible to erase recollection of remarks once heard, or undo impressions once created. If the viewpoint of even *one* justice was tainted by personal bias or interest (as in this instant case and in *Lavoie* and *Kountz*), then the opinions of all participants become tainted by their exposure to such bias. No one can ever know for certain what his or her opinion might have been if the biased judge's viewpoint had not been heard. This concern is all the greater where the court is closely divided. The only way to provide an impartial, unbiased determination is for the case to be heard and decided de novo by a special court empaneled under the provisions of Alabama Code § 12-2-14 (1975).

17. As observed in the 1974 decision of *Ex parte White*, 53 Ala. Crim. App. 377, 300 So.2d 420, the Supreme Court of the United States has many times in the history of our country written pronouncements concerning the requirements of due process and in the 1955 case of *In re Murchison*, 349 U.S. 133, 75 S.Ct. 623, 99 L.Ed. 942, it concluded that a fair trial in a fair tribunal is a basic due process requirement. Further, that court, speaking through Mr. Justice Hugo Black, held as follows:

> "Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness. To this end no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome. That interest cannot be defined with precision. Circumstances and relationships must be considered. This Court has said,

> however, that 'Every procedure which would offer a possible temptation to the average man as a judge * * * not to hold the balance nice, clear, and true between the State and the accused denies the latter due process of law.' *Tumey v. State of Ohio*, 273 U.S. 510, 532, 47 S.Ct. 437, 444, 71 L.Ed. 749. Such a stringent rule may sometimes bar trial by judges who have no actual bias and who would do their very best to weigh the scales of justice equally between contending parties. But to perform its high function in the best way 'justice must satisfy the appearance of justice.' *Offutt v. United States*, 348 U.S. 11, 14, 75 S.Ct. 11, 13, 99 L.Ed. 11."

[*See Murchison*, 349 U.S. at 136, 75 S.Ct. at 625, 99 L.Ed. at 946. *See also, Medlin v. Taylor*, 101 Ala. 239, 13 So. 310 (1893); *Ex parte Cornwell*, 144 Ala. 497, 39 So. 354 (1905); *Ex parte White, supra; Shell v. Shell*, 48 Ala. Civ. App. 668, 267 So.2d 461 (1972).]

18. Nationwide has been denied due process of the law.

WHEREFORE, Nationwide moves that this Court withdraw the opinion announced herein on February 8, 1985, and also withdraw the opinions previously announced in the recent cases of *Aetna Fire and Casualty Company v. Lavoie, supra*, and *Continental Assurance Company v. Kountz, supra*. Nationwide further moves that all the justices of this Court recuse themselves and that a special court be appointed to consider this appeal de novo, pursuant to the provisions of Alabama Code § 12-2-14 (1975). Nationwide prays for such other, further or different relief as may be appropriate under these premises.

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Oral argument en banc is requested on this motion. This is a case of first impression. It is a uniquely serious situation certainly warranting oral argument before this Court en banc.

/s/ Bert S. Nettles
BERT S. NETTLES

Appendix L

IN THE SUPREME COURT OF ALABAMA

NATIONWIDE MUTUAL INSURANCE COMPANY, Appellant,	)	CASE NUMBER 82-536 82-917
V.	)	
HENRY GERRARD CLAY, Appellee.	)	

AMENDMENT TO
MOTION FOR WITHDRAWAL OF OPINIONS
AND SUGGESTION OF DISQUALIFICATION

(Filed February 27, 1985)

Comes now appellant Nationwide Mutual Insurance Company ("Nationwide") and amends its Motion captioned "MOTION FOR WITHDRAWAL OF OPINIONS AND SUGGESTION OF DISQUALIFICATION" that was filed in this cause on February 22, 1985, to include the following additional ground:

19. Nationwide has been denied due process of the law in violation of both the Constitution of the United States of America and the Constitution of Alabama of 1901.

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